Banco de la República

Report by the Board of directors to the Congress of the Republic

July 2004

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Bogotá, Colombia
July 29, 2004

Chairman and Other Members
Constitutional Standing
Third Committees
Senate and House of Representatives
Republic of Colombia

Dear Sirs:

The Board of Directors of Banco de la República, pursuant to Article 5, Law 31 of 1992, hereby submits to the Congress of the Republic of Colombia, for its consideration, a report on macroeconomic performance in 2004 to date, the targets adopted by the Board for the current year, and the prospects for the different macroeconomic variables. The last section outlines the make-up of international reserves and the projected financial situation of Banco de la República.

Sincerely,

Miguel Urrutia Montoya
General Manager

I. Introduction

The macroeconomic policies applied in Colombia since late 2003 have been decisive to preventing the change in the prospects for international financial markets from jeopardizing the vigorous growth now characterizing the Colombian economy.

The report presented to the Congress of the Republic of Colombia describes the state of the Colombian economy in the early months of the year and prospects for the remainder of 2004. Economic activity continued to expand. According to the National Bureau of Statistics (DANE), gross domestic product (GDP) rose by 4.08% during the first quarter of the year. If illegal crops are excluded, the increase was 4.24%. Sectors such as construction (12.1%), commerce (5.8%) and industry (4.4%) were particularly important in terms of their evolution. Agriculture (illegal crops not included) grew by 4.03%. The external environment remained favorable for Colombia and the region, thanks to the trend in the demand for export products, better terms of trade and the influx of capital. Nevertheless, there were recent changes on the international financial markets, anticipating a possible interest-rate hike by the United States Federal Reserve Bank (Fed). This was manifest in high stock, financial and exchange market volatility in Colombia.

Chapter II of this report contains a brief description of the exchange intervention strategy Banco de la República is using as part of the inflation-targeting scheme. It is important to note that the combination of macroeconomic policies applied in Colombia since late 2003 has been decisive to preventing the change in prospects for international financial markets from jeopardizing the vigorous growth now characterizing the Colombian economy. The monetary and exchange policies adopted by the Board of Directors of Banco de la República (the Board) during those months were based on the assumption that low external interest rates were only temporary. Therefore, the possibility of a reverse in capital flows sometime in the future justified intervention in the exchange market to accumulate international reserves and to make the exchange rate less volatile. The strategy to this end called for purchasing substantial amounts of foreign currency, coupled with moderate reductions (on two occasions) in the Bank's intervention rate, as permitted by the tendencies in inflation.

The rate of employment in Colombia continues to depend on the recovery in production...

On the fiscal front, accounts have evolved as planned at the start of the year, and the end of 2004 should see a consolidated deficit in the public sector equal to 2.5% of GDP. This would be on target. Further adjustments will be required in the medium term to achieve fiscal sustainability for the country and to reduce the public debt as a share of GDP. The approval of proposed pension and tax reforms would be of considerable help in this respect, as would passage of the bill to modernize the Budget Act.

Chapter III discusses the positive outlook for the economy during the remainder of the year. Economic growth is expected to be around 4.0%, exceeding the forecast in the last *Report by the Board of Directors to the Congress of the Republic* (3.8%). Despite the volatility on financial markets, the external environment should continue to be favorable. As a result, external demand should continue to increase and terms of trade are expected to remain high. In addition, external financing for the public sector during the current year is ensured by the national government's recent decision to use US $500 million in international reserves made available by Banco de la República as of November 2003 to substitute the foreign bond issues scheduled for this amount. Under these circumstances, actual projections for the balance-of-payments current account deficit are lower than those indicated in the March 2004 *Report to Congress,* since the current account deficit is expected to equal 1.8% of GDP and not 2.6%. This is due to an increase of 11.9% in imports and a growth of 14.5% in exports. Chapter III also shows that, despite a possible increase in the annual rate of inflation in the third quarter, projections are favorable, as annual inflation will surely be somewhere in the 5%-to-6% target range by the end of 2004.

The rate of employment in Colombia continues to depend on the recovery in production.

Employment in Colombia remains tied to the recovery in productive activity. In fact, economic growth has allowed for an increase in both the extent and quality of employment, as suggested by the recent decline of almost 1.0 percentage point (pp) in unemployment in the 13 major cities for the month of May. Yet, further economic expansion is essential for increased recovery in employment and an even bigger decline in unemployment.

The findings of a study conducted by Banco de la República on how the minimum wage affects income distribution in Colombia are discussed at the end of Chapter III. The existence of a minimum wage has a positive impact on minimum-wage earners, but is negative for those who earn less. This last group includes the unemployed and the underemployed, who face fewer possibilities for formal employment.

Chapter IV discusses how Colombia's international reserves were managed in the early part of the year. Despite an accumulation of reserves, indicators of the country's external vulnerability are still near their critical values.

Chapter V lists projected profits for 2004 at 140.3 billion pesos, which is less than the profits reported for 2003 and the projection in March 2004.

This is due to depreciation of the international reserve portfolio in June, owing to the rise in international interest rates, a stronger dollar against currencies such as the euro and the yen, and the decline in gold prices on the international market. Although the projected return on reserves in 2004 points to a low yield on the portfolio, unanticipated movement in the value of other currencies against the dollar or in the price of gold pose certain risks that could affect the Bank's financial statements by the end of the year.

Despite an accumulation of reserves, indicators of the country's external vulnerability are still at levels near their critical values.

Banco de la República has a reserve to absorb an eventual exchange loss provoked by changes in the dollar compared with other currencies. This reserve expands with the profits generated by an increase in the net value of assets and liabilities in foreign currency due to exchange variations between the U.S. dollar and other reserve currencies, or declines in the event of losses registered for this item. Therefore, even if Banco de la República were to suffer exchange depreciation losses in 2004, they could be offset with existing reserves.

II. Macroeconomic Policy

Emerging economies are more exposed to external shocks from financing and terms of trade than other, more developed countries. This is due, in part, to a lack of depth in their financial systems. Recent literature shows that exchange intervention in most emerging economies makes it possible to curb or reduce the impact of these external shocks on the exchange market.

Monetary policy in Colombia is governed by a target-inflation scheme that is designed to keep inflation low and to ensure stable product growth based on the long-term trend in inflation. Consequently, the goal is price stability with maximum sustained growth in product and employment.

A. The Inflation Targeting Strategy and Exchange Market Intervention

The inflation targeting strategy in Colombia is combined with exchange market intervention by Banco de la República as another way to avoid volatility in economic growth and in real exchange rates. Intervention in this market also has been required to secure enough international reserves to deal successfully with external shocks to the country. The inflation targeting strategy is facilitated by a regime that allows for a flexible exchange rate. Emerging economies are known to be more exposed to external shocks from financing and terms of trade than other more developed countries. This is due, in part, to a lack of depth in their financial systems. Recent literature shows that exchange intervention in most emerging economies makes it possible to curb or reduce the impact of these external shocks on the exchange market. This is particularly valid if these shocks threaten compliance with short- or mid-term inflation targets, or if the country's stock of international reserves needs to be increased to build confidence in the economy or to enhance its credibility.

Economic authorities in countries like Colombia, where the targeting strategy is supplemented with sporadic exchange-market interventions, must ensure this action is compatible with monetary policy and that the signals being sent to economic agents are coherent. If exchange market intervention is to be consistent with an inflation targeting strategy, the following basic principles must be observed:

Exchange market intervention is a way to supplement the policy on interest rates and the inflation targeting strategy, and should not aim for a specific exchange rate.

- The interest rate is the chief monetary-policy instrument and must be managed according to prospects for inflation.
- Exchange market intervention must support and not offset the policy on intervention interest rates.
- Exchange market intervention is a way to supplement the policy on interest rates and the inflation targeting strategy, and should not aim for a specific exchange rate. It also should alleviate shocks originating within the exchange market.
- Through exchange intervention, countries can accumulate international reserves to help strengthen their external position.

B. Exchange Intervention and the Trend in the Exchange Rate

Banco de la República has intervened in the exchange market on a number of occasions since 1999, the year Colombia adopted a floating exchange system. This has been done to avoid excessive volatility through control options designed for this purpose. The Bank also has intervened to accumulate international reserves at times of excessive appreciation in the exchange rate (e.g. in 2001 and between late 2003 and early 2004). Another reason for intervention is to temper excessive peso devaluation that jeopardizes compliance with inflation targets, as was the case in late 2002. On the whole, the Bank has intervened more through auctions to accumulate international reserves in times of appreciation than to rundown the stock of reserves.

Between December 1999 and July 2004, Banco de la República intervened in the exchange market 50 times (Table 1). There have been 44 option auctions to accumulate international reserves, three to rundown reserves and three to control volatility in the exchange rate by reducing reserves. With this mechanism, participating agents have the option to sell or to buy a specific amount of foreign currency from Banco de la República, provided

Table 1

Banco de la República Intervention in the Exchange Market
(December 1999 - July 2004)

	Options to Accumulate International Reserves (Put Options)	Options to Rundown International Reserves (Call Options)	Call Options for Volatility Control 1/
Activation rule	TRM < PM20 de la TRM 2/	TRM > PM20 TRM 2/	TRM > 104% del PM20 TRM 2/
No. of auctions	44	3	3
Auction range	Entre US$30 m y US$250 m	US$200 m	US$180 m
Amount auctioned (accumulated)	US$4,325 m	US$600 m	US$540 m
Amount exercised (accumulated)	US$2,505 m	US$345 m	US$414 m
Amount exercised/Net international reserves (NIR)	21.2%	2.9%	3.5%
NIR at July 12, 2004: US$ 11,828 million			

PM20: 20-day moving average.
1/ To date, there have been no put options to control volatility. The activator for these options is TRM < 104% of PM20 TRM.
2/ TRM moving average for the last 20 working days.
Source: Banco de la República.

conditions are right to exercise the option.[1] However, during the time an option is valid (generally one calendar month or the term indicated in the auction invitation), the condition for its exercise might or might not occur. Even if conditions are right, those who hold the option are at liberty to exercise it, depending, among other factors, on their exchange expectations. This helps to explain why the total amounts auctioned by Banco de la República are not exercised in their entirety. For example, US$4,325 million in put options were auctioned during the period under study and only 56% (US$2,505 million) were exercised.

All these interventions were done according to clearly defined criteria that are known to the public. The idea is to maintain the essence of the floating system, without trying to achieve or maintain a particular exchange rate.

Figure 1 illustrates the extent to which the representative market rate (TRM) deviated from its 20-day moving average as of December 1999 and the Bank's intervention. There is a correlation between behavior of the exchange rate and intervention by the Bank. All the interventions were at times of transitory and cyclical trends in the exchange rate, which eventually

[1] When this mechanism was designed, Banco de la República established a clear set of rules and regulations as to when holders are allowed to exercise their options. Put options may be exercised the day the representative market rate (TRM) falls below the moving average for the last 20 days. In contrast, call options may be exercised the day the TRM is above its 20-day moving average. According to the Bank's rules on intervention, volatility options are activated automatically when the TRM is 4% above its 20-day moving average (call options) or falls short by 4% or more (put options). Further information on how Banco de la República intervenes in the exchange market is available on the Bank's website at

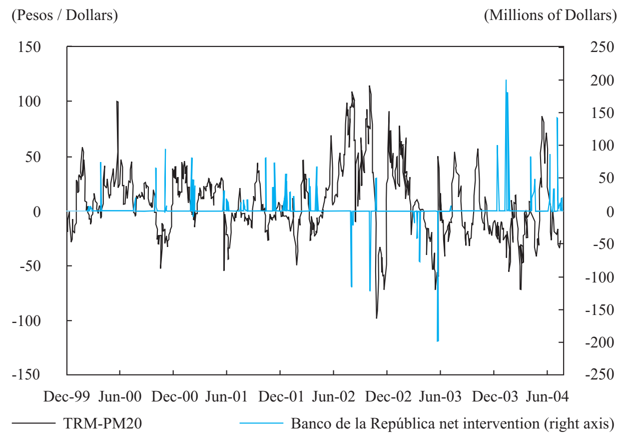
http://www.banrep.gov.co/opmonet/intervencion/e_mecintbcorep.pdf.

reversed. Intervention by the Bank does not reinforce any particularly trend in the exchange rate. In other words, put auctions are not held when the exchange rate is depreciating, nor is there an attempt to rundown international reserves when the rate is appreciating.

International reserves were purchased between 1999 and 2001 to replenish the stock that had been drained by loss of confidence and the economic crisis in 1999. The Bank used call options to lower international reserves between March and May 2003, as the models placed projected inflation for that year above the target. This was due to the excessive increase in the exchange rate as of mid-2002. There has been a period of appreciation between December 2003 and 2004 to date, in which the Bank has intervened to accumulate international reserves.

Figure 1

Banco de la República Net Intervention and TRM Deviation from Its 20-Day Moving Average
December 1999 - July 2004



Source: Banco de la República.

The strategy for accumulating international reserves allows for the fact that Colombia has a certain degree of external vulnerability, which makes it necessary to have a larger stock of international reserves. As explained in the Board's report to Congress in March of this year, although Colombia has an almost ideal stock of international reserves, it is still not enough to deal with an external crisis of medium proportions.[2] In light of that consideration, the Bank was willing to provide the government with up to US$500 million in international reserves.

However, Banco de la República has continued to accumulate international reserves, as it believes the country's external vulnerability has increased compared with December 2003. This is due to appreciation in the exchange rate and because large capital flows have entered the economy and can quickly reverse if the international environment changes. The same is true of the exchange rate. As mentioned in the last report, these abrupt changes usually occur and are frequent after a major increase in external capital flows. Accordingly, the decision to accumulate reserves is based on the assumption that the current appreciation is only temporary and, if reversed, could imply a sharp correction that would prompt higher inflation in the future and less productive activity, provided there are not enough reserves to soften the impact of any such movement.

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2 For more on this topic, see pages 67 and 68 in the March 2004 edition of *The Report by the Board of Directors to the Congress of the Republic.*

The more a country overcomes its fiscal problems and achieves macroeconomic stability, the less it needs to accumulate international reserves.

The more a country overcomes its fiscal problems and achieves macroeconomic stability, the less it needs to accumulate international reserves, provided that increased stability is manifest in a high degree of credibility with external and internal agents. This credibility is expressed by an increase in the rating given to the country by foreign investors and by greater access to foreign borrowing. In this respect, Colombia needs to accumulate more international reserves, owing to the loss of its investment-grade rating in 1999.

The impact of exchange appreciation on tradable inflation and core inflation, with a negative product gap (i.e. GDP is still below its potential level), enabled the Board to reduce the intervention interest rate on two occasions. The Bank's purchase of foreign currency in this context was coherent with the looser monetary policy adopted in the first half of the year. In this way, exchange intervention has respected the basic principles outlined earlier.

The purchase of sizeable amounts of reserves implies other challenges for the authorities. If not sterilized, these purchases can have an impact on short-term interest rates, placing them at levels that are incompatible with inflation targets. This can occur if base money expands as a result of intervention and reduces the short term interest rate to levels below those regarded as coherent with target inflation and with product stabilization near its level of long-term sustainability.

Colombia needs to accumulate more international reserves, owing to the loss of its investment-grade rating in 1999.

Therefore, this requires sterilization or compensation for the expansion occasioned by purchases of international reserves. In 2004, Banco de la República, in an amount equivalent to 50.0% of the purchased reserves, achieved this compensation with sales of TES; the rest was accomplished through adjustments in the Bank's daily repo quotas.

C. Monetary and Exchange Policy in 2004

1. Background Information

According to the *Inflation Report* for December 2003, the inflationary trend in 2004 and 2005 will depend on: i) how quickly the product gap is closed and its impact on non-tradable inflation, and ii) the extent and duration of appreciation in the exchange rate and how it affects inflation in tradable goods.

The inflation forecasts presented in that report were based on assumptions that the gap would close by 1.0 PP in 2004 and that average nominal appreciation this year would be 0.5%, followed by 7.0% depreciation in

2005. Given these conditions, the results of the main forecast model - the transmission mechanism model (TMM) - showed a high probability of complying with the 5%-to-6% inflation target for 2004. However, the probability of keeping inflation during future years within the announced range (between 3.5% and 5.5%) was greater if interest rates on 90-day time certificates of deposit (CD) increases by nearly 100 basis points (bp) this year and in 2005.[3]

According to the March report, exchange appreciation that lasts longer and exceeds expectations would allow for a more neutral monetary policy or one that is more lax (a reduction in rates). This is due to the effect of increased appreciation on inflation forecasts for the period of time when monetary policy is strongest. In light of these considerations, the Board upheld the Bank's intervention rates at a meeting in January 2004 and called for an auction of US$200 million in put options on January 9 to soften the revolutionist trend in the exchange rate without altering its tendency, which is determined by market forces.

2. Decisions on Monetary Policy in the First Six Months of 2004

The way external indicators and the productive sector evolved during the first quarter of 2004 ratified the growth tendencies identified in last December's *Inflation Report.* The economy continued to accelerate, thanks to external and internal conditions that favored good performance in the tradable and non-tradable sectors.

Nevertheless, exchange appreciation in the first quarter was greater than expected. This was due to less capital flight from residents, inflows of new direct and portfolio investments, and the continued improvement in terms of trade compared with the projections.

Based on these trends and on new information, the relevant forecasts were updated to define the monetary policy. For example, the forecast for GDP growth was raised by 4.0% for 2004 and average nominal appreciation expected for 2004 was increased according to the projections for the balance of payments, but with an important surge in the exchange rate during 2005. The estimated product gap was altered as of February, compared with the December report. In spite of having narrowed gradually throughout the year, it was not closing as fast as estimated in the December report, due to the positive impact on installed capacity occasioned by more private investment.

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3 It is important to remember that monetary policy operates with a backlog. Consequently, movement in short-term nominal interest rates has more of an impact on inflation after a period estimated at somewhere between six and eight quarters.

The increase in appreciation and the fact that the product gap was not closing as quickly as expected lowered the inflation forecasts for 2005 and 2006. This meant it was possible to reach levels of inflation akin to the target ranges announced for 2004 and 2005, with lower interest rates than the ones forecast in the December report. Given these considerations, the Board adopted two decisions at its meetings in February and March that modified the stance of Colombia's monetary policy.

To begin with, it cut the intervention rate by 50 bp; that is, by 25 bp in February and another 25 bp in March. Secondly, the Board regarded the period of exchange appreciation at the end of 2003 as temporary. Therefore, accumulation of more international reserves to deal with possible reversals in capital flows and any medium and long-term adjustments in the exchange rate that might affect the trend in future inflation was considered advisable. Accordingly, it announced the purchase of up to US$700 million in additional reserves between April and July 2004, through put options and with amounts announced on a monthly basis. In response to this decision, option auctions were called to accumulate US$200 million in April, June and July, and US$250 million in May. These last options were the only ones not exercised.

The Board also announced the Bank would compensate for a portion of the foreign currency purchases with a definitive sale of TES on the secondary market. This would cover up to 50% of the reserves purchased, making growth in monetary aggregates coherent with keeping short-term interest rates at the levels required to ensure compliance with the inflation target for 2004 and to guide inflation in 2005 towards the announced range (between 3.5% and 5.5%).

At the same time, the government indicated it was willing to use the US$500 million in international reserves announced by Banco de la República as the maximum rundown available for payment on the external debt. By the end of June, the government had used US$100 million.

a. Interest Rates

Monetary policy in recent years, as indicated in earlier reports, has been counter-cyclical to the extent that low real interest rates (below their long-term levels) have boosted the recovery in economic activity and employment within a context of lower inflation.

As mentioned, Banco de la República cut its intervention rate by 50 bp during 2004 to supply primary liquidity to the economy. The Bank regulates liquidity through (i) auctions for which it sets quotas and closing rates for expansion and contraction operations, and (ii) access to windows used to manage the liquidity surpluses or shortfalls of intermediaries, at Lombard rates. The last cut (in March) placed intervention rates at the following levels: expansion auction minimum, 6.75%, Lombard expansion, 10.50%; contraction auction maximum, 5.75%; and Lombard contraction, 4.75% (Table 2).

A change in the Bank's intervention rates affects the interbank rate, which was 6.87% nominal at the end of June (Figure 2). The interbank rate has been less volatile, thanks to the policy applied since 1999 to reduce the

Table 2

Banco de la República Interbank and Intervention Rates
(Percentage)

Effective Date From	Effective Date To	Contraction Minimum (Lombard)	Maximum for Contraction Auctions	Minimum for Expansion Auctions	Expansion Maximum (Lombard)	Interbank Rate End of (*)	Interbank Rate Real
Dec-17-01	Jan-18-02	6.25	7.50	8.50	12.25	8.21	0.78
Jan-21-02	Mar-15-02	6.00	7.00	8.00	11.75	7.78	1.78
Mar-18-02	Apr-12-02	5.25	6.25	7.25	11.00	7.25	1.51
Apr-15-02	May-17-02	4.25	5.25	6.25	10.00	6.18	0.32
May-20-02	Jun-14-02	3.75	4.75	5.75	9.50	5.65	(0.56)
Jun-17-02	Jan-17-03	3.25	4.25	5.25	9.00	5.13	(2.11)
Jan-20-03	Apr-28-03	4.25	5.25	6.25	10.00	6.18	(1.55)
Apr-29-03	Feb-20-04	5.25	6.25	7.25	11.00	7.32	0.98
Feb-23-04	Mar-19-04	5.00	6.00	7.00	10.75	7.18	0.91
Mar-23-04		4.75	5.75	6.75	10.50	6.95	0.70

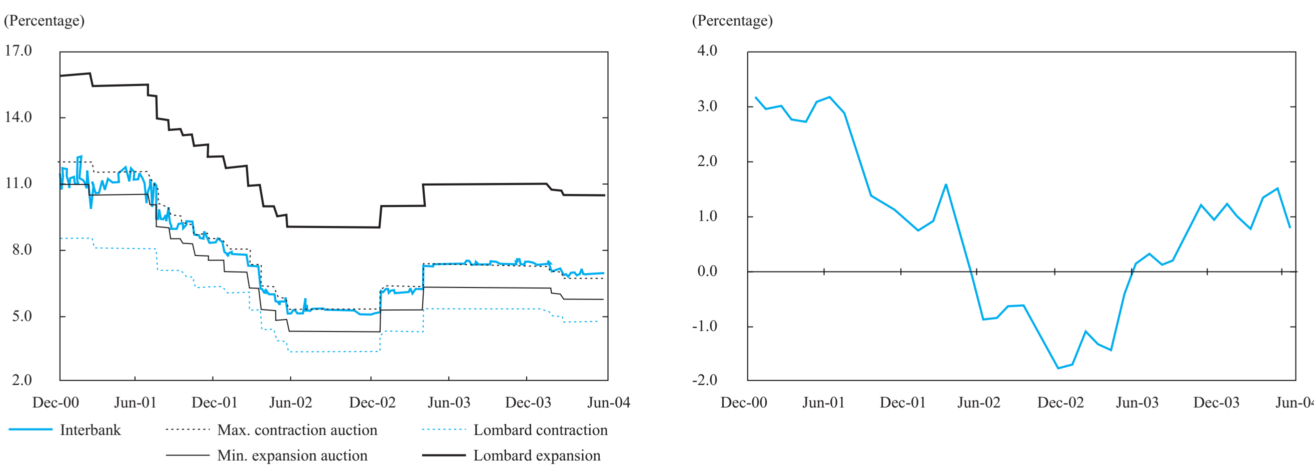
(*) Banco de la República survey.
Source: Banco de la República.

Figure 2

Banco de la República Interbank and Intervention Rates

Interbank and Intervention Rates

Real Intrebank Rate

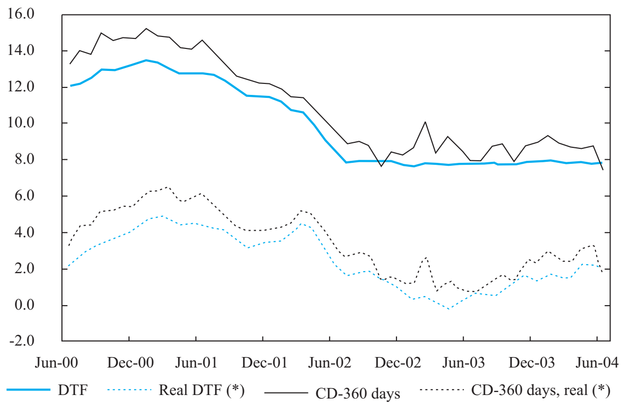


Source: Banco de la República.

Figure 3

Nominal Interest and Real Deposit Rate

(Percentage)

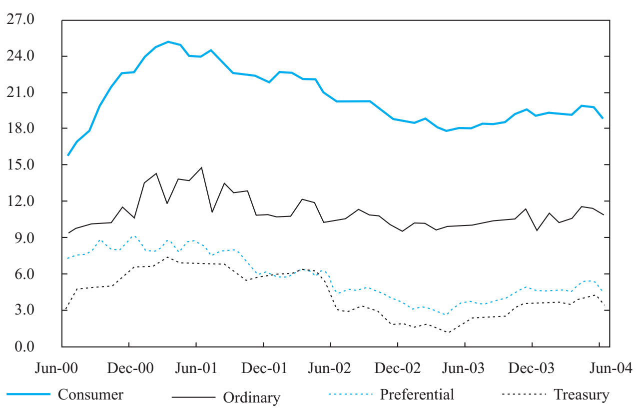


(*) Deflated with the CPI.
Source: Banco de la República.

Figure 4

Real Placement Rates

(Percentage)



Source: Banco de la República.

dispersion in rates. Moreover, as illustrated in Figure 2, although the interbank rate turned positive in real terms, it has been low (below 1.0%) since May 2003 (0.8% in June).

The deposit rate,[4] using the month-end DTF as an indicator, has remained at historically low levels, staying below 8% since July 2002. The DTF was 7.85% at the end of June 2004. In real terms, it was 1.69%, with an increase of 32 bp during the course of the year. The trend in deposit rates for longer maturities (360-day CDs) has been similar to that of the DTF (Figure 3).

In June, nominal interest rate on consumer loans averaged 26.0%, ordinary loans 17.7%, preferential 10.8% and Treasury 9.6%. All lending rates, in real terms, stayed relatively stable during the course of the year (Figure 4).

Trading volume on the domestic public debt market was high and prices rose steadily during the early months of 2004 and up until the first half of April. Like the build-up in local currency, this occurred in most Latin American countries, as in other emerging economies, due to the abundance of international liquidity. In the case of Colombia, it was reinforced by the downward trend in inflation, which allowed the decline in TES interest rates to continue.

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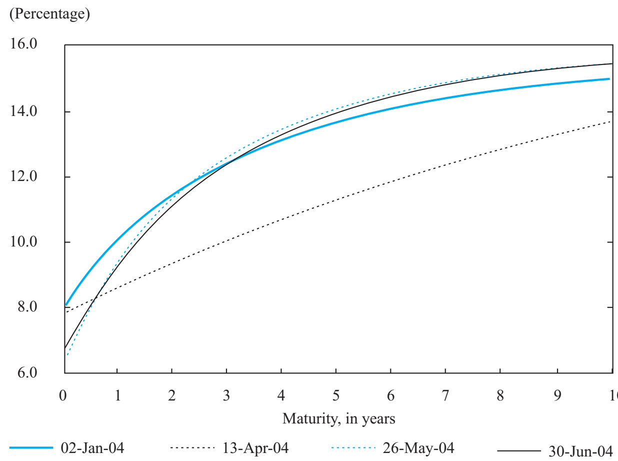
4 Calculated as the weighted average interest on 90-day time deposits.

5 Each point on the zero-coupon curve reflects the interest rate for a flow paid at that point in time. In other words, the six-month maturity on the zero-coupon curve reflects the yield on a flow to be paid six months from today. This is different from a yield curve where the points indicate the domestic rate of return on securities with this maturity, but their flow payments can occur at different points in time. If securities had no coupon payments and only payment at the end, the zero-coupon curve and the yield curve would be the same.

The zero-coupon curve[5] for TES of all maturities fell up until mid-April (Figure 5). During the year prior to April 13, trading rates on the secondary market declined by 222 bp, on average, for the five most liquid indicators on the market.

Figure 5

ZERO-COUPON CURVE OF FIXED-RATE TES



Source: Banco de la República.

This tendency reversed itself in mid-April. As of that point and up until May 26, the rates for the same indicators rose by 189 bp, on average, correcting almost the entire course of three and a half months in only a few weeks. This might have been due to changes in expectations about what would happen with interest rates in the United States and world liquidity. For example, in late March and throughout April, the market received information on better than expected U.S. economic performance and possible inflationary pressures. The new expectations of agents were first evident in an increase in the U.S. treasury bond curve, then in a strong reaction to risk premiums on the sovereign debt of emerging countries, and finally in the rise in exchange rates and interest on the local debt paper of those countries.

June saw a return to relative stability in the rates at which TES were traded, since local agents were waiting for the Fed's decision on interest rates. International and local agents expected an increase of 25 bp, according to what the Fed had stipulated on June 30. This decision was well received by the market and generated a slight decline in TES interest rates. However, there was continued uncertainty about how U.S. interest rates would behave in the future.

b. Monetary Aggregates

During the current year to June, base money and the M1 monetary aggregate rose at respective annual rates of 17.5% and 16.5%, exceeding nominal GDP growth in the first quarter. Cash continued to show important growth, averaging a nominal increase of 19.3% and real growth of 12.6% by June, compared with 19.8% and 11.5% in the same period of 2003. The demand for bank reserves also rose, averaging a nominal increase of 13.4% and real growth of 7.1%. These are below the rates observed for the same period in 2003 (Table 3 and Figure 6).

An analysis of base money according to its source indicates the total expansion of 3,065 billion pesos registered between June 2003 and June 2004 originated mainly with 2,657 billion pesos in purchases of international

Table 3

Monetary Aggregates
Annual Percentage Change in the Monthly Average of Weekly Data

		Base	Cash	Reserve	M1	Quasimoney	M2	PSE	M3
		Nominal							
2002	Dec.	20.3	20.9	18.6	18.3	4.7	8.5	5.7	7.4
2003	Jan.	19.2	22.0	12.8	22.9	5.2	10.0	6.5	8.2
	Feb.	19.7	21.0	16.7	21.1	7.1	10.8	8.9	10.2
	Mar.	17.6	18.3	16.1	20.3	9.1	12.1	10.5	11.4
	Apr.	22.2	22.0	22.8	18.2	9.2	11.6	8.9	10.3
	May.	16.6	18.6	11.9	13.4	9.3	10.4	9.6	10.6
	Jun.	16.0	17.1	13.5	13.6	10.3	11.2	10.6	11.3
	Jul.	14.6	15.5	12.5	12.9	10.5	11.2	11.4	11.9
	Aug.	13.0	13.6	11.6	12.9	12.3	12.5	13.4	13.4
	Sep.	13.5	12.5	16.1	13.0	10.0	10.9	12.1	12.1
	Oct.	13.1	14.9	8.9	15.3	9.9	11.4	11.0	11.5
	Nov.	15.7	16.9	12.7	18.2	10.1	12.3	11.2	11.8
	Dec.	17.3	17.5	16.7	17.3	9.4	11.8	11.1	11.9
2004	Jan.	16.5	19.0	9.9	15.8	9.9	11.6	11.0	12.0
	Feb.	17.9	20.5	11.4	18.4	9.5	12.1	10.9	12.0
	Mar.	17.4	20.0	11.2	16.5	9.7	11.6	11.6	12.5
	Apr.	15.0	17.2	9.7	15.3	9.5	11.2	12.3	12.8
	May.	19.8	19.0	21.7	17.3	11.6	13.2	11.1	12.0
	Jun.	18.7	19.6	16.5	16.0	13.5	14.2	11.3	12.3
Average at June:									
	2003	18.6	19.8	15.6	18.2	8.4	11.0	9.2	10.3
	2004	17.5	19.3	13.4	16.5	10.6	12.3	11.4	12.3
		Real							
2002	Dec.	12.4	13.0	10.9	10.6	(2.2)	1.4	(1.2)	0.3
2003	Jan.	11.0	13.6	5.0	14.4	(2.0)	2.4	(0.8)	0.8
	Feb.	11.6	12.8	8.8	12.9	(0.1)	3.3	1.6	2.8
	Mar.	9.3	9.9	7.9	11.8	1.4	4.2	2.7	3.5
	Apr.	13.3	13.1	13.9	9.6	1.2	3.5	1.0	2.3
	May.	8.2	10.1	3.9	5.3	1.4	2.5	1.8	2.6
	Jun.	8.2	9.2	5.8	6.0	2.9	3.7	3.2	3.8
	Jul.	7.1	7.9	5.1	5.4	3.3	3.9	4.1	4.5
	Aug.	5.4	5.9	4.1	5.2	4.7	4.9	5.7	5.7
	Sep.	6.0	5.0	8.4	5.5	2.7	3.5	4.6	4.6
	Oct.	6.1	7.8	2.2	8.2	3.2	4.6	4.2	4.6
	Nov.	9.0	10.2	6.2	11.3	3.7	5.8	4.8	5.4
	Dec.	10.1	10.4	9.6	10.2	2.7	5.0	4.3	5.0
2004	Jan.	9.7	12.1	3.5	9.1	3.5	5.1	4.5	5.4
	Feb.	10.9	13.4	4.8	11.4	3.0	5.4	4.3	5.4
	Mar.	10.5	13.0	4.7	9.7	3.3	5.1	5.0	5.9
	Apr.	9.0	11.1	4.0	9.3	3.8	5.4	6.4	6.9
	May.	13.7	13.0	15.5	11.3	5.9	7.4	5.5	6.3
	Jun.	11.9	12.8	9.9	9.4	7.0	7.7	5.0	5.9
Average at June:									
	2003	10.3	11.5	7.6	10.0	0.8	3.3	1.6	2.6
	2004	10.9	12.6	7.1	10.0	4.4	6.0	5.1	6.0

Source: Banco de la República.

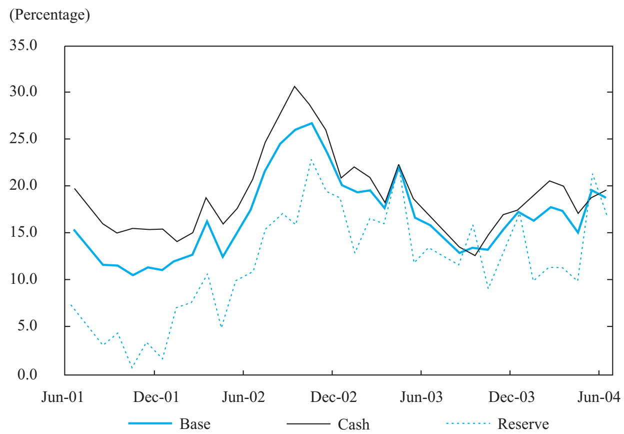
reserves. Additionally, during these 12 months, the government received 803 billion pesos in profits, while net purchases of TES by the Bank came to 5.0 billion pesos and the National Treasury account with Banco de la República was down by 546 billion pesos (Table 4).

As with base money, the growth in aggregate money supply (M1) during the year has been slightly below the levels registered for the same period last year, going from a nominal growth rate of 18.2% in June 2003 to 16.5% on the same date in 2004. Yet, in real terms, M1 growth has been similar to the rate for the same period last year (10.0%) and is well above real growth in the economy. This is due to the tendency in its components; namely, cash and current accounts (Figure 7).

During the course of the year to June, growth in the broad monetary aggregate (M3) increased with respect to same period in 2003, going from 10.3%

FIGURE 6

BASE MONEY AND ITS USE
ANNUAL GROWTH RATES OF THE MONTHLY AVERAGE



Source: Banco de la República.

TABLE 4

BASE MONEY SOURCES
1999-2004
(BILLIONS OF PESOS)

	Annual Flow at June					
	1999	2000	2001	2002	2003	2004 1/
Government	2,480	832	914	1,667	1,673	262
Profit transfer	1,244	516	1,453	1,226	830	803
In pesos	1,244	516	1,453	1,226	1,481	803
In dollars 2/					(651)	
Net purchase-TES	1,092	400	(623)	371	760	5
Treasury accounts with Banco de la República	143	(84)	84	70	83	(546)
OMA and liquidity quotas	1,730	(691)	(1,215)	1,128	1,492	154
Net purchase of foreign exchange	(1,437)	692	1,445	(517)	(703)	2,657
Portfolio receipts 3/		(112)	(225)	(4)	(6)	(2)
Others	44	249 4/	18	181 5/	53	(5)
Total	2,817	971	938	2,457	2,510	3,065
Base balance	9,739	10,710	11,648	14,104	16,614	15,735

1/ Full year at July 2, 2004.
Base June 27/03: 12,669.2 billion pesos.
Base July 02/04: 15,734.7 billion pesos.
2/ In terms of issue, the transfer of profits in dollars is a monetary contraction operation similar to the sale of international reserves.
3/ Mainly Granahorrar.
4/ Includes the purchase of US$55 million in foreign exchange from multilateral organizations, which is126 billion pesos more.
5/ Includes the purchase of US$52 million in foreign exchange from multilateral organizations, which is 31 billion pesos more.
Source: Banco de la República.

to 12.3% average annual change. M3 also expanded from 2.6% to 6.0% in real terms (Table 3). This is compatible with increased economic growth, the vigorous expansion in consumer credit (including microcredit), which rose at an annual rate of 20.0% for the year to date compared with 12.9% for the same period in 2003 (Figure 8), and better indicators of portfolio quality (overdue portfolio/gross portfolio) and solvency (technical equity/risk-weighted assets) for credit institutions (Figures 9 and 10).

A look at the dynamics of M3, by components, shows an average annual increase of 11.4% at June in liabilities subject to reserve requirements (PSE),[6] compared with 9.2% the year before. There has been some recovery in deposits through bonds issued by the financial system. During the period in question, these increased by 1,063 billion pesos at an annual growth rate of 50.1%.

The rise in savings deposits and current accounts slowed from 21.4% and 16.7% average annual growth at June 2003 to respective average rates of 14.6% and 14.8% during the course of 2004 (Figure 11).

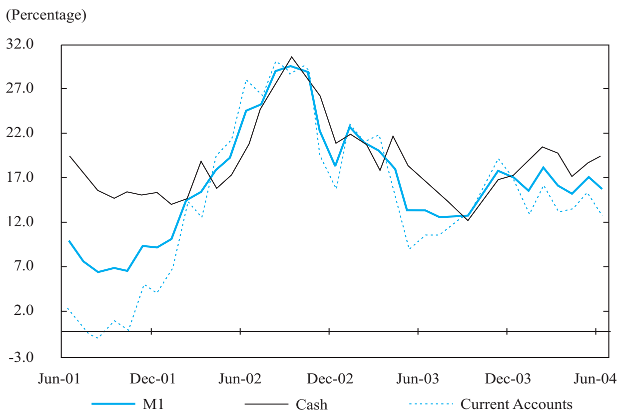
As to the financial portfolio according to sectors, there was an increase in private-sector investment during the current year to May 2004, including investments in both public debt instruments (30.4%) and deposits with the financial system. These had registered growth rates in excess of nominal GDP growth since mid-2003 (10.7%, on average, at May 2004). Similarly, public-sector PSE continued to grow at notoriously high rates (20.1%), as illustrated in Table 5. A particularly important aspect of the rise in public-sector investments was the rapid expansion in certificates of deposit and savings accounts. So far this year, they have increased by 5.6% and 49.5%, respectively (Table 6). Current accounts and bonds issued by the financial system were the outstanding elements in the private portfolio, with respective increases of 16.5% and 37.1%.

However, the year to date has witnessed a slowdown in portfolio growth (Table 7), particularly for commercial and mortgage portfolios, while the consumer loan portfolio on the rise, as mentioned earlier (Figure 8). The slowdown in commercial credit is probable due to the use of alternative sources of financing, such as increased funding with own resources, thanks to profits generated by the productive sector and major bond sales in 2003. The increase in net foreign borrowing is also a factor.

6 These include all current liabilities that are maintained by credit institutions and constitute part of the broad monetary aggregate (M3).

Figure 7

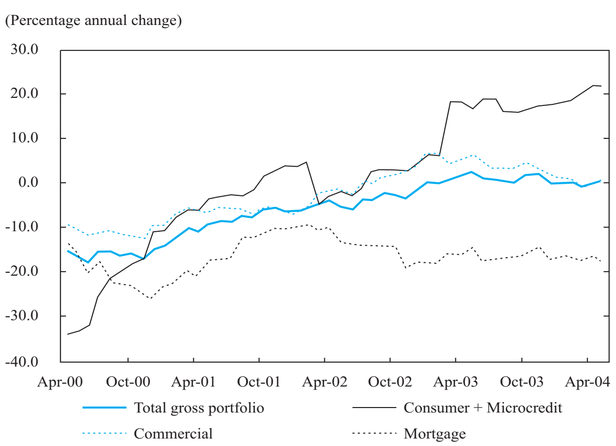
M1 and Its Components
Annual Growth Rates of the Monthly Average



Source: Banco de la República.

Figure 8

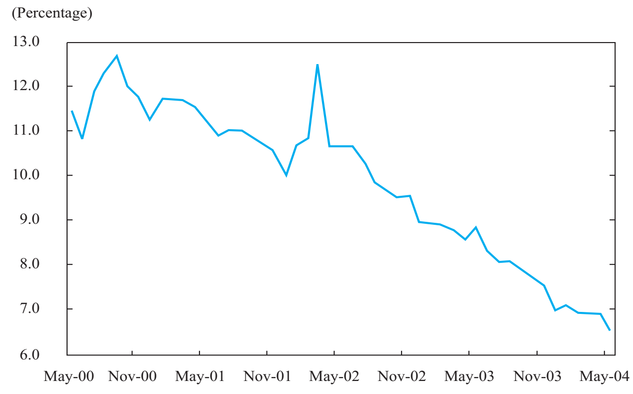
Real Gross Portfolio in Domestic Currency + Total Foreign Currency, by Type of Portfolio



Source: Banco de la República, based on data from the Banking Superintendent.

Figure 9

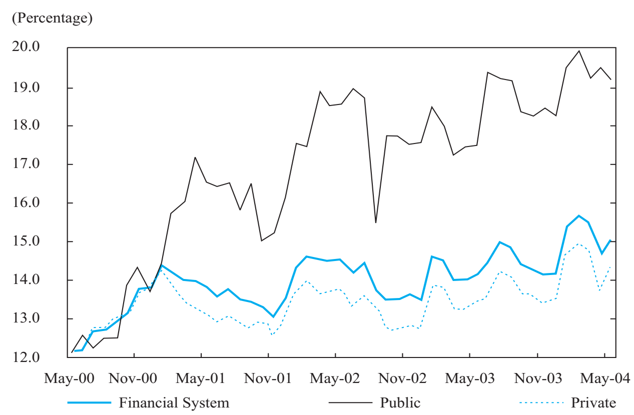
Portfolio Quality Indicator (Overdue/Gross)



Source: Banco de la República, based on data from the Banking Superintendent.

Figure 10

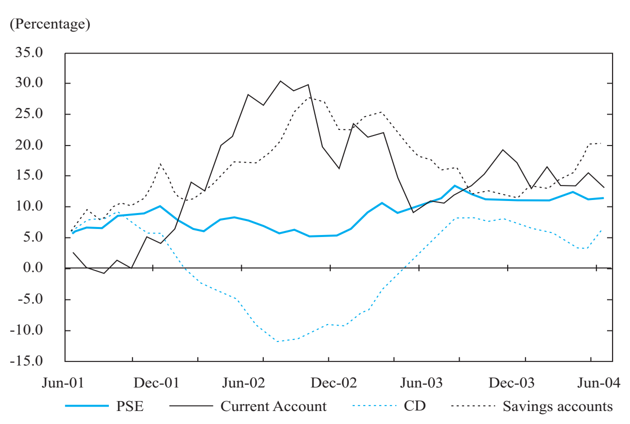
Solvency Ratio - Credit Institutions (*)



(*) Technical equity/ risk-weighted assets.
Source: Banco de la República, based on data from the Banking Superintendent.

Figure 11

PSE and Its Components
Annual Rates of Growth in the Monthly Average



Source: Banco de la República.

Table 5

Financial Portfolio of the Productive Sector
(Billions of pesos)

		Total			Public Sector			Private Sector (*)		
		M3	TES	M3 + TES	M3	TES	Total	M3	TES	Total
						Balance				
1998		57,046	12,040	69,086	7,306	9,745	17,051	49,740	2,295	52,035
1999		60,336	15,491	75,827	5,440	11,126	16,565	54,896	4,365	59,262
2000		62,696	20,299	82,995	6,654	13,994	20,648	56,042	6,306	62,348
2001		68,580	24,744	93,323	9,405	16,463	25,868	59,174	8,281	67,455
2002		73,073	28,859	101,931	10,781	17,141	27,922	62,292	11,717	74,009
2003		82,234	31,613	113,846	13,497	16,612	30,109	68,737	15,001	83,738
2004	Jan.	82,476	32,494	114,971	13,416	16,694	30,109	69,061	15,800	84,861
	Feb.	82,740	33,473	116,213	14,548	16,607	31,155	68,192	16,867	85,059
	Mar.	83,699	34,320	118,019	15,844	16,774	32,618	67,855	17,546	85,401
	Apr.	83,716	34,328	118,044	15,246	16,900	32,145	68,470	17,429	85,899
	May	84,154	34,249	118,404	17,172	17,513	34,685	66,983	16,736	83,719
						Absolute annual change				
1999		3,290	3,451	6,741	(1,866)	1,381	(486)	5,156	2,071	7,227
2000		2,360	4,808	7,168	1,214	2,868	4,082	1,146	1,940	3,086
2001		5,883	4,445	10,328	2,751	2,469	5,221	3,132	1,975	5,107
2002		4,493	4,115	8,608	1,375	678	2,054	3,118	3,437	6,554
2003		9,161	2,754	11,915	2,716	(529)	2,186	6,445	3,283	9,729
2004	Jan.	9,318	3,156	12,473	1,826	(698)	1,127	7,492	3,854	11,346
	Feb.	8,640	2,975	11,615	1,705	(1,066)	639	6,935	4,041	10,976
	Mar.	9,605	3,702	13,307	3,670	(854)	2,816	5,935	4,556	10,491
	Apr.	9,699	3,174	12,873	2,245	(979)	1,267	7,454	4,153	11,606
	May	8,550	2,448	10,998	3,342	(536)	2,806	5,208	2,983	8,192
						Percentage annual change at the end of:				
1999		5.8	28.7	9.8	(25.5)	14.2	(2.8)	10.4	90.2	13.9
2000		3.9	31.0	9.5	22.3	25.8	24.6	2.1	44.4	5.2
2001		9.4	21.9	12.4	41.4	17.6	25.3	5.6	31.3	8.2
2002		6.6	16.6	9.2	14.6	4.1	7.9	5.3	41.5	9.7
2003		12.5	9.5	11.7	25.2	(3.1)	7.8	10.3	28.0	13.1
2004	Jan.	12.7	10.8	12.2	15.8	(4.0)	3.9	12.2	32.3	15.4
	Feb.	11.7	9.8	11.1	13.3	(6.0)	2.1	11.3	31.5	14.8
	Mar.	13.0	12.1	12.7	30.2	(4.8)	9.4	9.6	35.1	14.0
	Apr.	13.1	10.2	12.2	17.3	(5.5)	4.1	12.2	31.3	15.6
	May	11.3	7.7	10.2	24.2	(3.0)	8.8	8.4	21.7	10.8
						Percentage annual average change each year				
2000		2.7	35.8	9.3	(11.3)	32.1	13.9	5.0	48.2	7.8
2001		7.6	17.8	10.1	25.1	11.5	15.5	5.4	36.0	8.1
2002		7.8	20.2	11.0	36.4	1.7	13.3	4.0	62.2	10.4
2003		11.0	14.0	11.9	21.2	9.6	14.2	9.2	21.4	11.0
To May, 2004		12.4	10.1	11.7	20.1	(4.7)	5.7	10.7	30.4	14.1

(*) Does not include TES in the financial sector.
Source: Banco de la República. Calculations by the Economic Studies Division (SGEE) based on information from the Trust and Securities Department and the Banking Superintendent.

Main Deposits of Credit Institutions

End of:		Current Account			CDs			Savings		
		Public	Private	Total	Public	Private	Total	Public	Private	Total
						Billions of pesos				
1999		1,732.9	5,071.2	6,804.0	1,103.3	22,698.9	23,802.2	1,047.7	16,109.3	17,157.0
2000		2,363.0	7,074.1	9,437.0	1,075.6	22,048.1	23,123.7	1,146.3	15,682.3	16,828.6
2001		3,287.2	7,115.8	10,403.0	1,615.7	22,763.6	24,379.3	1,676.0	17,448.7	19,124.7
2002		3,393.4	8,217.6	11,611.0	1,466.2	20,638.8	22,105.0	2,862.2	20,016.7	22,878.9
2003	Jan.	2,918.0	7,160.3	10,078.3	1,334.8	21,416.2	22,750.9	3,538.0	20,302.7	23,840.8
	Feb.	3,028.5	6,923.5	9,952.0	1,326.9	21,777.9	23,104.9	3,874.3	20,107.4	23,981.7
	Mar.	2,993.2	7,018.8	10,012.0	1,406.2	22,409.6	23,815.8	3,649.4	20,071.0	23,720.4
	Apr.	2,871.3	6,839.3	9,710.6	1,598.8	22,230.6	23,829.3	4,421.6	19,629.2	24,050.8
	May	2,721.2	6,750.4	9,471.6	1,804.8	22,538.4	24,343.2	4,264.4	19,846.8	24,111.2
	Jun.	3,008.8	7,461.3	10,470.1	1,627.8	22,242.2	23,870.1	4,193.9	20,140.5	24,334.4
	Jul.	2,749.6	7,241.2	9,990.7	1,628.4	22,554.5	24,182.9	4,100.4	20,447.0	24,547.4
	Aug.	2,748.9	7,505.5	10,254.5	1,742.4	22,486.9	24,229.3	4,269.5	20,578.8	24,848.3
	Sep.	2,814.3	7,520.6	10,334.9	1,481.7	22,775.8	24,257.5	4,276.4	20,478.6	24,754.9
	Oct.	2,780.2	7,622.2	10,402.3	1,626.7	22,740.4	24,367.1	4,910.4	20,732.5	25,642.9
	Nov.	3,136.4	7,907.5	11,043.9	1,473.7	22,754.8	24,228.5	4,411.1	21,186.7	25,597.8
	Dec.	3,813.9	9,305.4	13,119.3	1,511.2	22,028.3	23,539.5	3,749.2	21,801.2	25,550.4
2004	Jan.	2,700.8	8,812.0	11,512.7	1,617.5	22,557.2	24,174.7	4,456.5	22,278.9	26,735.4
	Feb.	3,260.1	8,162.4	11,422.5	1,377.4	23,239.9	24,617.2	5,485.0	21,405.8	26,890.8
	Mar.	3,273.2	8,313.1	11,586.3	1,400.7	23,325.2	24,725.9	5,925.4	21,145.6	27,071.1
	Apr.	3,206.9	7,815.0	11,021.9	1,519.5	23,300.6	24,820.1	6,139.7	21,601.7	27,741.5
	May	3,578.6	7,361.5	10,940.1	1,958.3	23,180.9	25,139.2	7,632.7	21,137.6	28,770.2
						Annual percentage change				
2000		36.4	39.5	38.7	(2.5)	(2.9)	(2.9)	9.4	(2.7)	(1.9)
2001		39.1	0.6	10.2	50.2	3.2	5.4	46.2	11.3	13.6
2002		3.2	15.5	11.6	(9.2)	(9.3)	(9.3)	70.8	14.7	19.6
2003	Jan.	35.2	22.1	25.6	(13.2)	(7.5)	(7.9)	71.9	19.3	25.0
	Feb.	27.6	17.5	20.4	(18.2)	(5.1)	(6.0)	73.1	20.4	26.7
	Mar.	26.2	21.0	22.5	(4.1)	(1.8)	(2.0)	48.6	18.6	22.4
	Apr.	2.8	15.8	11.7	(0.7)	(1.3)	(1.2)	61.5	13.4	20.0
	May	(1.7)	13.1	8.4	14.0	1.9	2.7	42.8	13.8	18.1
	Jun.	3.8	15.3	11.7	7.6	4.1	4.3	53.4	10.8	16.4
	Jul.	2.3	15.7	11.7	10.1	7.1	7.3	39.1	12.5	16.2
	Aug.	4.7	15.9	12.7	20.4	7.1	7.9	38.1	9.7	13.7
	Sep.	10.1	17.7	15.5	(6.0)	9.2	8.2	31.8	7.6	11.1
	Oct.	9.1	19.7	16.7	(4.4)	8.5	7.5	47.0	6.6	12.5
	Nov.	14.5	18.8	17.6	(7.9)	9.1	7.8	16.5	8.2	9.5
	Dec.	12.4	13.2	13.0	3.1	6.7	6.5	31.0	8.9	11.7
2004	Jan.	(7.4)	23.1	14.2	21.2	5.3	6.3	26.0	9.7	12.1
	Feb.	7.6	17.9	14.8	3.8	6.7	6.5	41.6	6.5	12.1
	Mar.	9.4	18.4	15.7	(0.4)	4.1	3.8	62.4	5.4	14.1
	Apr.	11.7	14.3	13.5	(5.0)	4.8	4.2	38.9	10.0	15.3
	May	31.5	9.1	15.5	8.5	2.9	3.3	79.0	6.5	19.3
						Annual average percentage change				
Jan.-Jun./03		15.7	17.5	16.7	(2.4)	(1.6)	(1.7)	58.5	16.1	21.4
Jul.-Dec./03		8.9	16.8	14.5	2.5	8.0	7.5	33.9	8.9	12.4
Jan.-Dec./03		12.3	17.2	15.6	0.0	3.2	2.9	46.2	12.5	16.9
Jan.-May/04		10.5	16.5	14.7	5.6	4.8	4.8	49.5	7.6	14.6

Source: Banco de la República, SGEE based on the monthly balance and the format submitted by financial institutions for operations with public agencies.

TABLE 7

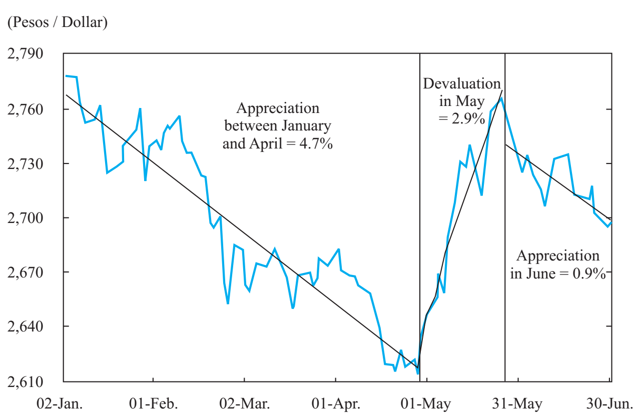
ADJUSTED AND UNADJUSTED GROSS PORTFOLIO (*)
(ANNUAL PERCENTAGE CHANGE)

Enf of:		Real growth				Nominal growth				F/C adjusted in dollars
		D/C	F/C	Total	D/C adjusted (pr)	D/C	F/C	Total	D/C adjusted (pr)	
2001		(5.0)	(20.7)	(6.2)	(3.8)	2.3	(14.6)	1.0	3.5	(16.9)
2002		(1.7)	(0.2)	(1.6)	(1.9)	5.2	6.8	5.3	5.0	(14.6)
2003	Jan.	(0.7)	7.9	(0.2)	(1.2)	6.7	15.8	7.2	6.1	(10.3)
	Feb.	(0.1)	5.3	0.2	(0.9)	7.1	12.9	7.4	6.3	(11.8)
	Mar.	(0.0)	10.3	0.6	(0.6)	7.6	18.7	8.2	6.9	(9.3)
	Apr.	1.5	(0.2)	1.4	(0.6)	9.4	7.6	9.3	7.1	(15.2)
	May	3.7	(15.2)	2.5	1.3	11.7	(8.7)	10.5	9.1	(25.7)
	Jun.	2.6	(19.4)	1.3	1.4	10.0	(13.6)	8.6	8.7	(26.5)
	Jul.	2.4	(28.2)	0.3	1.1	9.6	(23.2)	7.3	8.2	(30.0)
	Aug.	2.8	(29.9)	0.5	1.1	10.2	(24.9)	7.8	8.5	(28.3)
	Sep.	2.5	(31.1)	0.1	1.1	9.7	(26.2)	7.2	8.2	(27.7)
	Oct.	3.9	(29.5)	1.6	1.5	10.7	(24.9)	8.3	8.2	(27.8)
	Nov.	3.9	(29.0)	1.8	3.0	10.3	(24.7)	8.0	9.3	(26.1)
	Dec.	2.4	(35.0)	0.0	1.8	9.1	(30.7)	6.5	8.4	(28.6)
2004	Jan.	2.2	(33.1)	(0.0)	1.7	8.6	(28.9)	6.1	8.0	(24.2)
	Feb.	2.4	(31.6)	0.2	1.8	8.8	(27.3)	6.5	8.2	(19.8)
	Mar.	0.4	(24.0)	(1.0)	0.1	6.7	(19.3)	5.1	6.4	(10.9)
	Apr.	0.3	(12.8)	(0.4)	n.d.	5.9	(8.0)	5.1	n.a.	0.4
	May	0.7	(4.9)	0.4	n.d.	6.1	0.2	5.8	n.a.	4.9
					Average percentage change					
May./03-May./04		2.3	(24.9)	0.6	1.4	9.0	(20.0)	7.1	8.3	(20.8)
Jan.-May./03		0.9	1.6	0.9	(0.4)	8.5	9.3	8.5	7.1	(14.5)
Jan.-May./04		1.2	(21.3)	(0.2)	1.2	7.2	(16.7)	5.7	7.5	(9.9)

D/C: Domestic currency. **F/C:** Foreign currency
n.a.: Not available
(*) Includes institutions in the process of liquidation. Does not include special financial institutions.
Source: Banco de la República, based on the monthly statements of financial institutions.

FIGURE 12

TREND IN THE EXCHANGE RATE: 2004



Source: Banco de la República.

c. Trend in the Exchange Rate

The representative market rate (TRM) appreciated by 2.8% during the first quarter of 2004 from 2,778 pesos at December 31, 2003 to 2,700 pesos at June 30, 2004. Three periods stand out in these six months. (i) There was a revaluation of 4.7% in the exchange rate between January 1 and April 30, continuing the tendency observed during the last quarter of 2003. (ii) The TRM was extremely volatile between April 30 and May 31, increasing by 77.9 pesos with 2.9% devaluation during the month. (iii) In June, it appreciated by 0.9% during the month (Figure 12).

The behavior of the exchange rate between January and June was associated with several factors, such as the international situation and a foreign exchange surplus in the productive sector. This was due, in part, to better terms of trade and more exports. The external factor in this trend was associated with the prevalence of low interest rates in other economies (particularly the United States and the European Union).

The increased volatility of the exchange rate in May seems to have been the result of a change in investors' expectations about an increase in interest rates on the U.S. market and economic news from Brazil (Figure 13). In June, the exchange rate and the country-risk indicator dropped again, thanks to increased calm on international financial markets.

In the first half of 2004, together with appreciation of the peso, exchange figures[7] showed a major accumulation of foreign currency in the real sector (US$1,120 million), primary because of US$1,062 million in current account transactions. However, a comparison between these figures and the amount accumulated during the same six months in 2003 shows net income in foreign currency from capital account translations (US$754 million) exceeded the growth in current account income (US$560 million) (Table 8).

Traditional measurements of the real exchange rate (ITCR-PPI and ITCR-CPI)[8] remain high, despite appreciation as of September 2003 (Figure 14). By June 2004, the ITCR-PPI had appreciated at

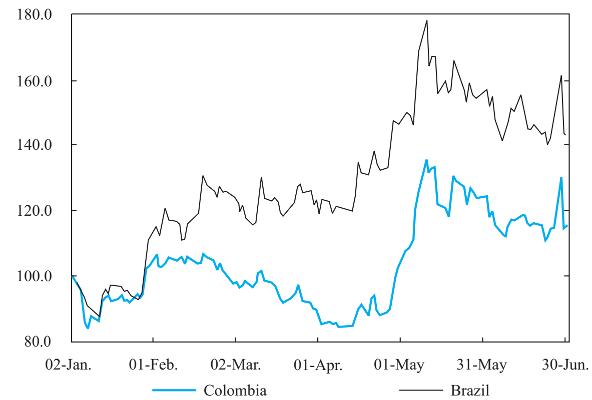
7 The figures on the exchange balance (Table 10) pertain only to operations in the productive sector that are negotiated directly on the exchange market. They do not include income from the yield on international reserves and National Treasury operations associated with the external debt.

8 The real exchange rate index (ITCR) is the relative price indicator that measures changes in a country's competitiveness with respect to its main trading partners. The ITCR-PPI and the ITCR-CPI are used traditionally and are calculated with the producer price index (PPI) and the consumer price index (CPI), as measurements of external and domestic prices.

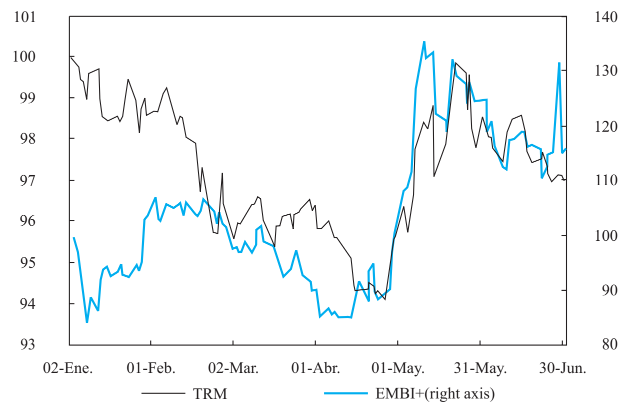
Figure 13

EMBI Index + Exchange Rate: 2004
(Base 100 = January 2, 2004)

EMBI Index+ Colombia and Brazil



TRM and EMBI + Colombia

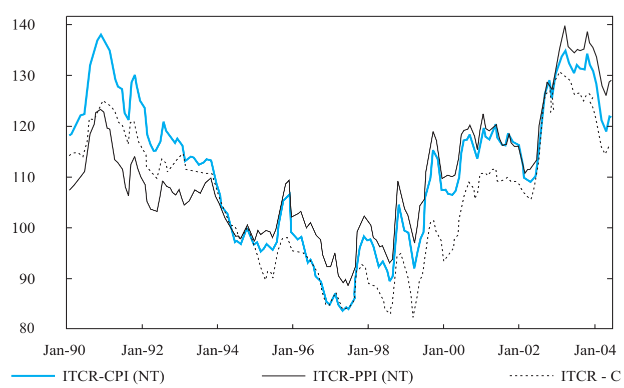


EMBI: Emerging Market Bond Index.
Source: Bloomberg.

Figure 14

Real Exchange Rate Index:
Non-traditional Trade (ITCR PPI-CPI) and with Third Countries (ITCR-C) (*)

(Geometric percentage, 1994= 100)



(*) CPI deflator, weighted moving average of non-traditional trade.
Source: Banco de la República.

Table 8

Exchange Flows - Productive Sector
(Millions of dollars)

	Accumulated		2004						Accum. Jun-04 (pr)	Accum. Change at June
	2003	Jun-03	Jan.	Feb.	Mar.	Apr.	May	Jun.(pr)		
Exchange flows- productive sector 1/	**(90.6)**	**(112.2)**	**307.5**	**84.5**	**272.3**	**283.6**	**95.5**	**77.0**	**1,120.4**	**1,232.7**
Current account	**1,368.0**	**502.6**	**6.5**	**160.5**	**238.9**	**157.2**	**266.0**	**233.1**	**1,062.2**	**559.6**
A, Trade balance	(2,628.4)	(1,262.1)	(277.6)	(241.2)	(195.6)	(221.4)	(219.2)	(229.7)	(1,384.7)	(122.6)
Merchandise exports	2,847.3	1,327.5	232.4	253.4	301.3	289.2	289.5	303.5	1,669.3	341.9
Merchandise imports	5,475.7	2,589.6	510.0	494.5	496.9	510.7	508.7	533.2	3,054.0	464.4
B, Services and net transfers	3,996.4	1,764.7	284.1	401.6	434.6	378.7	485.2	462.8	2,446.9	682.2
Net financial services	(228.2)	(122.3)	(14.4)	(8.8)	(26.2)	(55.4)	(28.6)	(15.5)	(148.9)	(26.5)
Private sector	(214.8)	(113.0)	(12.2)	(8.8)	(25.3)	(55.3)	(28.6)	(11.7)	(142.0)	(29.0)
Public sector	(13.4)	(9.3)	(2.2)	0.1	(0.9)	(0.0)	(0.0)	(3.8)	(6.9)	2.4
Net non-financial services	1,209.6	472.4	66.6	173.6	203.1	192.0	245.1	210.2	1,090.6	618.1
Net transfers	3,014.9	1,414.6	231.9	236.8	257.7	242.0	268.7	268.1	1,505.2	90.6
Capital account	**(1,624.2)**	**(721.6)**	**259.1**	**(84.3)**	**(26.0)**	**195.9**	**(247.9)**	**(64.3)**	**32.6**	**754.2**
A. Private Sector	(1,579.9)	(632.5)	191.6	24.5	(8.3)	132.6	(229.5)	(43.6)	67.4	700.0
Net loans	(933.2)	(577.7)	(49.2)	(35.0)	25.9	(15.8)	(126.1)	(51.9)	(252.2)	325.6
Outlays	381.8	168.7	43.5	33.4	103.9	75.2	25.3	31.3	312.7	144.0
Amortization	1,314.9	746.5	92.8	68.5	77.9	91.0	151.4	83.3	564.9	(181.6)
Foreign investment in Colombia	1,531.2	814.2	223.9	119.9	128.3	233.8	116.0	273.1	1,094.9	280.7
Direct investment	285.8	162.2	16.4	20.4	16.8	17.3	12.5	8.8	92.1	(70.1)
Supplementary investment	1,265.3	638.0	111.7	125.9	86.9	254.5	102.5	236.6	918.1	280.0
Portfolio investment	(19.9)	14.0	95.8	(26.4)	24.7	(38.0)	1.1	27.6	84.8	70.8
Colombian investment abroad	(960.7)	(227.2)	38.3	50.7	(57.8)	(93.6)	(117.1)	(13.1)	(192.7)	34.5
Direct investment	(57.7)	(20.4)	(7.6)	(1.0)	(4.6)	(4.5)	(1.9)	(4.4)	(24.0)	(3.6)
Portfolio investment	(903.0)	(206.8)	45.9	51.7	(53.2)	(89.1)	(115.2)	(8.8)	(168.7)	38.1
Net current accounts	(1,217.2)	(641.8)	(21.3)	(111.0)	(104.7)	8.2	(102.3)	(251.6)	(582.6)	59.2
B. Public Sector	(44.2)	(89.1)	67.5	(108.8)	(17.7)	63.3	(18.4)	(20.8)	(34.8)	54.3
Net loans	(158.4)	(56.0)	(8.6)	(0.2)	(1.4)	(1.4)	(1.3)	(1.7)	(14.6)	41.3
Special operations	120.4	(21.8)	72.9	(106.6)	(21.7)	62.1	(23.6)	(26.7)	(43.6)	(21.8)
Financial investments	(6.2)	(11.3)	3.2	(2.0)	5.4	2.7	6.5	7.6	23.4	34.7
Statistical errors and omissions 2/	**165.6**	**106.8**	**41.9**	**8.3**	**59.3**	**(69.5)**	**77.4**	**(91.7)**	**25.6**	**(81.2)**

(pr) Preliminary.
1/ Does not include the purchase-sale of foreign exchange by the National Treasury.
2/ Pertains to foreign exchange flows not reported in the current account or the capital account in the balance of payments and changes in the PPI that are not reflected in exchange flows and have not been identified.
Source: Banco de la República.

an annual rate of 3.87% and the ITCR-CPI by 6.65%. The rates so far this year are 4.75% and 6.90%, in that order. However, real appreciation in Colombia could have been greater had consumer and producer inflation rates not been 1.3 pp and 3.7 pp lower than the respective averages for the country's 20 main trading partners during 2004. In annual terms, these rates were 0.8 pp and 4.0 pp less. It is, therefore, important to emphasize that low inflation helps to keep the real exchange rate at competitive levels.

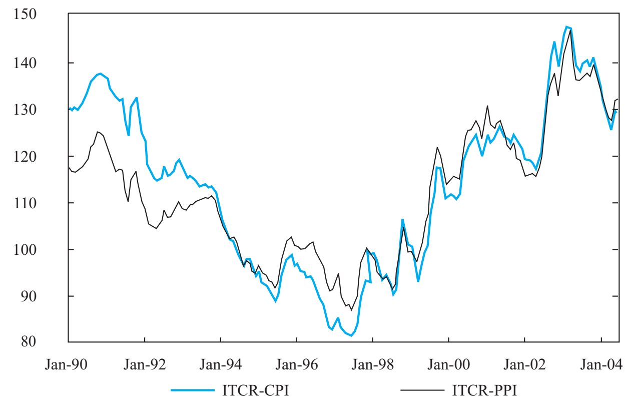
Low inflation helps to keep the real exchange rate competitive.

Another measure of the real exchange rate is the ITCR with third countries (ITCR-C). It estimates the trend in the competitiveness of four Colombian products (coffee, bananas, flowers and textiles) sold to the United States market.[9] Like previous measurements, the ITCR-C at June showed 8.67% real annual appreciation and 6.57% for the year to date. A bilateral ITCR measured against the United States shows similar results (Figure 15).

FIGURE 15

BILATERAL ITCR COMPARISON BETWEEN COLOMBIA AND THE UNITED STATES, ACCORDING TO PPI AND CPI

(Geometric percentage, 1994= 100)



Source: Banco de la República.

D. FISCAL POLICY

1. First Quarter Performance: 2004

At the close of the first quarter of the year, the consolidated public sector showed a deficit of 823 billion pesos, which is equivalent to 0.3% of annual GDP. Compared with the same period in 2003, this is evidence of better fiscal performance, especially in the decentralized sector. It also more than surpasses the goal set with the International Monetary Fund (IMF); that is, 1,200 billion pesos for the first quarter of 2004. The imbalance at the sectoral level is due to a combination of factors; namely, the central government deficit (1.7% of GDP), the cost of restructuring the financial system (0.1% of GDP) and the surplus of the decentralized sector, as well as Banco de la República and Fogafin. Together, they accounted for 1.7% of GDP (Table 9).

9 Competitiveness is measured by a same-currency comparison between the Colombian PPI and the PPI of the 23 countries that are Colombia's main direct competitors on the U.S. market for these goods.

TABLE 9

CONSOLIDATED PUBLIC SECTOR
FIRST QUARTER FISCAL BALANCE DEFICIT (-) OR SURPLUS (+)

Item	Billions of pesos		Percentage of GDP	
	2003	2004	2003	2004
Electricity	176.0	42.0	0.1	0.0
FAEP	(44.0)	(113.0)	(0.0)	(0.0)
Ecopetrol	1,062.0	1,302.0	0.5	0.5
Telecom	(22.0)	3.0	(0.0)	0.0
Other entities	375.0	601.0	0.2	0.2
Social security	256.0	640.0	0.1	0.3
Regional and local	437.0	957.0	0.2	0.4
National Coffee Fund	66.0	55.0	0.0	0.0
1. Decentralized Sector Subtotal	2,306.0	3,487.0	1.0	1.4
2. National Government	(3,942.0)	(4,218.0)	(1.8)	(1.7)
A. Total non-financial public sector (SPNF) (1 + 2)	(1,636.0)	(731.0)	(0.7)	(0.3)
B. Banco de la República cash loss and profit	590.0	389.0	0.3	0.2
C. Fogafin cash loss and profit	126.0	125.0	0.1	0.1
D. Cost of financial restructuring	(350.0)	(317.0)	(0.2)	(0.1)
E. Adjustments	133.0	(289.0)	0.1	(0.1)
F. Total consolidated public sector (A + B + C + D + E)	(1,137.0)	(823.0)	(0.5)	(0.3)

Source: Confis.

Central government (GNC) finances showed a deficit of 4,218 billion pesos. This is equivalent to 1.7% of GDP. Compared with the first quarter of 2003, revenue increased by 7.7% and expenses by 7.5%. Highlights in this respect include a rise in income tax, domestic and external value added tax (VAT), and levies on financial transactions, which grew at respective rates of 18.2%, 16.1%, 16.2% and 46.8%. For the most part, the increase in these items can be attributed to the tax reform adopted at the end of 2003 and to more momentum in economic activity last year and during 2004. However, revenue from customs tariffs declined by 5.1%, possibly due to the trend in the exchange rate and to a process aimed at rearranging imports in favor of goods subject to less duty (Table 10).

Operating expenses rose by 9.6%, while interest on the debt and investment payments declined by 0.2% and 34.8%, respectively. Operating expenses include personal services, which increased by 9.5%. General expenses rose by 2.7% and transfers by 10.1%. The growth in this last item is associated with outlays from the general income-sharing system and for retirement pensions, which grew in excess of 11.0% during the period.

The net GNC loan amounted to 102 billion pesos, with 139 billion pesos in new disbursements against 37 billion pesos in portfolio recovery. Disbursements via a special external debt account (CEDE) came to 80 billion pesos and backed debt transactions to 59 billion pesos.

The GNC deficit was financed with domestic credit and a transfer of profits from Banco de la República. Net external borrowing was negative by 82.0 billion pesos, thanks to 1,630 billion pesos in disbursements and 1,712 billion pesos in amortization. Net domestic borrowing came to 3,878 billion pesos, due to 5,907 billion pesos in disbursements and 2,029 billion pesos in amortization. In all, 5,563 billion pesos in TES were sold, including 3,291 billion pesos via auctions and 2,272 billion pesos through arranged and forced investments.

2. Fiscal Outlook for 2004

According to the report submitted by the Board in March, the target for the fiscal deficit in the public sector in 2004 is 2.5% of GDP. This has yet to change, despite recent adjustments in the government's fiscal projections, which led to a change in the composition of the deficit and prompted a review of several scheduled transactions, such as decapitalization of public funds and the sale of stock owned by the government in various companies. According to the latest official figures, the imbalance in GNC finances will

Central Government
First Quarter Fiscal Balance
(Billions of pesos)

	2003 I Quarter	2004 I Quarter	Annual Percentage Growth 2004/2003
I. Total revenue (A + B + C + D + E)	8,323.0	8,964.0	7.7
A. Tax	7,965.0	8,572.0	7.6
Income	2,664.0	3,150.0	18.2
Domestic VAT	2,646.0	3,072.0	16.1
External VAT	932.0	1,083.0	16.2
Taxes	494.0	469.0	(5.1)
Gasoline	252.0	255.0	1.2
Financial transactions	359.0	527.0	46.8
Others	618.0	16.0	(97.4)
B. Non-tax	57.0	47.0	(17.5)
C. Special funds	62.0	65.0	4.8
D. Capital revenue	211.0	248.0	17.5
E. Accrued revenue	28.0	32.0	14.3
II. Total expenses (A + B + C + D + E + F)	12,265.0	13,182.0	7.5
A. Interest	3,309.0	3,303.0	(0.2)
External	1,463.0	1,582.0	8.1
Domestic	1,846.0	1,721.0	(6.8)
B. Operational	7,172.0	7,858.0	9.6
Personal services	1,311.0	1,435.0	9.5
General expenses	375.0	385.0	2.7
Transfers	5,486.0	6,038.0	10.1
C. Investment	772.0	503.0	(34.8)
D. Net loan	178.0	102.0	(42.7)
E. Floating debt	629.0	1,203.0	91.3
F. Indexation TES B denominated in UVR (real value units)	205.0	213.0	3.9
III. Deficit (-) or surplus (+) (I-II) (*)	(3,942.0)	(4,218.0)	7.0
Cost of restructuring the financial system	350.0	317.0	(9.4)
IV. Financing (A + B + C + D)	(4,292.0)	(4,535.0)	5.7
A. Net external credit	1,950.0	(82.0)	(104.2)
Disbursements	3,683.0	1,630.0	(55.7)
Amortization	1,733.0	1,712.0	(1.2)
B. Net domestic credit	1,935.0	3,878.0	100.4
Disbursements	4,799.0	5,907.0	23.1
Amortization	2,864.0	2,029.0	(29.2)
C. Banco de la República profits	1,480.0	803.0	(45.7)
D. Others	(1,073.0)	(64.0)	(94.0)
V. Deficit as a percentage of GDP	(1.8)	(1.7)	

(*) Does not include the cost of restructuring the financial system.
Source: Confis.

come to 5.6% of GDP this year and will be offset, in part, by a surplus in the decentralized public sector equivalent to 3.1% of GDP (Table 11).

The fiscal outlook for the GNC points to 14.9% growth in revenue and 14.4% in expenditure. Tax revenue would increase by 15.2% and capital revenue by 16.6%. Income, domestic VAT and gasoline taxes promise to be the most dynamic, with 20.05, 10.9% and 12.6% growth, in that order.

As to expenditure, interest on the debt is expected to rise by 15.0% and operating expenses by 20.5%. Employee services will increase by 12.8%, general expenses by 21.7% and transfers by 22.4%. The net loan will amount to 723 billion pesos.

The deficit will be financed with credit, profits transferred from Banco de la República, and use of the National Treasury portfolio. There will be 3,295 billion pesos in net external credit and 6,873 billion pesos in net borrowing. TES sales are expected to reach 15,726 billion pesos.

3. Medium-term Fiscal Outlook

In its last two reports to Congress, the Board stressed the correlation between monetary and fiscal policy and the threat to economic stability posed by

TABLE 11

CONSOLIDATED PUBLIC SECTOR
FISCAL BALANCE: 2003-2004
DEFICIT (-) OR SURPLUS (+)

Item	Billions of pesos		Percentage of GDP	
	2003	2004 (proj)	2003	2004 (proj)
Electricity	755.0	466.0	0.3	0.2
FAEP	(139.0)	(265.0)	(0.1)	(0.1)
Ecopetrol	1,246.0	1,813.0	0.6	0.7
Telecom	(157.0)	106.0	(0.1)	0.0
Other entities	1,027.0	1,301.0	0.5	0.5
Social security	1,702.0	2,999.0	0.8	1.2
Regional and local	927.0	1,070.0	0.4	0.4
National Coffee Fund	311.0	12.0	0.1	0.0
1. Decentralized Sector Subtotal	5,672.0	7,502.0	2.5	3.1
2. National Government	(12,151.0)	(13,699.0)	(5.4)	(5.6)
A. Total non-financial public sector (SPNF) (1 + 2)	(6,479.0)	(6,197.0)	(2.9)	(2.5)
B. Banco de la República cash loss and profit	1,437.0	573.0	0.6	0.2
C. Fogafin cash loss and profit	582.0	424.0	0.3	0.2
D. Cost of financial restructuring	(941.0)	(901.0)	(0.4)	(0.4)
E. Adjustments	(691.0)	0.0	(0.3)	0.0
F. Total consolidated public sector (A + B + C + D + E)	(6,092.0)	(6,101.0)	(2.7)	(2.5)

(proj.) Projection
Source: Confis.

recurrent deficits that could make the public debt unsustainable. The March report highlights the problems encountered with managing GNC finances, particularly because of limited maneuverability for raising taxes, the rigid nature of most expenses, and the exaggerated growth in certain items such as retirement pensions, which will reach extraordinary levels in 2005, when the Social Security Institute (ISS) depletes its reserves. The report recommends a realistic assessment of the country's fiscal situation and continuation of the structural reform process. The idea is to lend medium- and long-term viability to public finances.

The present report reiterates the need to continue the structural reform process, based on a careful study of the country's fiscal situation and considering the dimensions of the chief problems with national finances.

The present report reiterates the need to continue the structural reform process, based on a careful study of the country's fiscal situation and considering the dimensions of the chief problems with national finances. This means the pension problem will have to be re-examined. It has worsened, despite a reform measure adopted at the beginning of 2003, which called for a gradual increase in contributions and revised the parameters for the system as a whole, particularly concerning the number of weeks contributed, the retirement age and the pension amount. Revision and amendment of the tax system, at both national and territorial level, is also a priority, as is adoption of the Budget Act, which would allow for a certain amount of flexibility in spending and give the government a good tool for reducing and streamlining its expenses.

E. Agreement with the IMF

The Executive Board of the International Monetary Fund (IMF) ratified the 2004 Stand-by Agreement with the Colombian government on December 24, 2003 to consolidate macroeconomic and structural policies and to improve the dynamics of the public debt. The agreement gives Colombia a total of 774 million in special drawing rights (SDR) for this year (approximately US$1,050 million), including an initial disbursement of 193.5 million SDR (nearly US$264 million). The remainder will be disbursed quarterly, pending compliance with the targets that have been established and subject to regular IMF review of the current program.

The Executive Board of the International Monetary Fund (IMF) ratified the Stand-by Agreement with the Colombian government for 2004 on December 24, 2003 to consolidate macroeconomic and structural policies and to improve the dynamics of the public debt.

Table 12 shows the targets for the first quarter of 2004 were met. Although inflation in March (6.2%) exceeded the target defined by the IMF for that month (6.0%), the stand-by agreement allows for a band of 2.0 pp above and below the specific target (4.0% to 8.0%). Any rate within this band is considered in line with the target.

Table 12

Program with the International Monetary Fund (IMF)

	Mar-04			IMF Target 1/	
	IMF Target 1/ (a)	Actual (b)	Difference (b) - (a)	Jun-04	Sep-04
NIR Floor (millions of dollars) 2/	10,240	11,019	779	10,300	10,400 *
Inflation target (percentage) 3/	6.00	6.22	0.22	6.00	5.70 •
Overall deficit ceiling in the consolidated public sector. as of January 1. 2003 (billion pesos) 4/	1,200	824	(376)	1,650	1,850 *
Accumulated net disbursement ceiling on the medium- and long-term external debt in the public sector. as of January 1. 2003 (millions of dollars) 5/	800	54	(746)	1,300	1,750 *°
Accumulated net disbursement ceiling on short-term external debt in the public sector. as of January 1. 2003 (millions of dollars) 5/	200	(81)	(281)	200	200 *°

1/ This is an indicative target, not a criterion for compliance.
2/ The technical memorandum in the IMF Agreement lowered the NIR floor by US$2 billion.
3/ The technical memorandum in the IMF Agreement calls for a band of two percentage points above or below the specific inflation target.
4/ Provisional information subject to a review of data reported by the financial system in the combined public sector.
5/ Provisional information at March 2004, subject to review.
Source: Banco de la República **(*)**, DANE **(•)** and Ministry of Finance and Public Credit **(°)**.

III. Inflation, Economic Activity and Employment

Economic performance during the remainder of 2004 will continue to be associated with external factors such as the trend in demand worldwide, terms of trade and the effect of international oil prices on the world economy. Uncertainty over capital flows is still the biggest risk. However, the economy can be expected to grow by nearly 4.0% in 2004.

During the first months of 2004, the economy kept on expanding at a healthy pace in response to positive factors on the external and domestic fronts. Domestic demand continued to recover, spurred by private investment. This is mainly the result of low real interest rates and more available income in the private sector, thanks to better terms of trade, an increase in foreign remittances during 2003, and the recovery in urban employment. Assets in certain sectors have increased because of higher real estate and stock prices. Domestic financing is more readily available, as demonstrated by the trend in consumer credit from the financial system and the funds available for companies.

Greater confidence on the part of consumers and the business community helped to boost domestic demand, as did improved access to international capital markets for both the public and private sectors. The expansion in non-tradable sectors, such as construction, commerce and transportation services, continued to be stimulated by a more solid domestic demand.

Prospects for growth on the external front in 2004 have improved for several of Colombia's trading partners and the increase in terms of trade is expected to continue, thanks to further growth in world demand. With a more favorable external environment, the balance-of-payments scenarios for 2004 show an increase (in dollars) of 14.5% in total exports (8.1% in 2003) and 8.2% in non-traditional exports (excluding gold and emeralds) compared with -3.2% in 2003. Imports are expected to rise by 11.9% (compared with 9.8% in 2003). This is due to more economic growth and the strength of investments.

Prospects for the capital account have changed in recent months. The anticipated hike in U.S. interest rates,[10] coupled with persistently high oil prices on the international market and investors who are increasingly wary of risk, made the financial markets extremely volatile. This, in turn, affected private capital flows into the emerging economies, especially in Latin America. Recently, calm returned to the markets, given expectations that adjustments in the Fed's short-term interest rate will remain gradual. Under these conditions, the trends on international financial markets are likely to remain stable, although with higher country-risk levels than those observed in the first quarter. In the case of Colombia, external public financing for 2004 is guaranteed.

Economic performance during the remainder of 2004 will continue to be associated with external factors such as the trend in demand worldwide, terms of trade and the effect of international oil prices on the world economy. Low real interest rates will continue to stimulate economic activity on the domestic front. The biggest risk is still the uncertainty over the behavior of capital flows, which could change suddenly and undermine confidence in the future of the economy. However, we believe this is a remote possibility and the economy can be expected to grow by nearly 4.0% growth in 2004.

The trend in the exchange rate will determine the course of tradable inflation, food prices and inflationary expectations throughout the year. Annual consumer inflation went from 6.5% in December 2003 to 5.4% in May 2004, following a sharp downward correction in tradable inflation. Unforeseen pressure on the prices of staple food and continuing high levels of inflation for regulated goods and services, including fuel, pushed annual total inflation to 6.06% in June. However, according to the latest estimates based on the projection models used by Banco de la República, inflation in 2004 is still expected to be in the upper part of the announced target range (between 5.0% and 6.0%).

A. Inflation

Core inflation was clearly on the decline in the first half of 2004, despite the surge in June. Annual core inflation, excluding food, was 5.87%. This is a considerable drop compared with 7% in December (Table 13). All other indicators of core inflation were down substantially, and the average

---

10 As the markets had anticipated, the Fed raised its short-term interest rate to 1.25% on June 30, 2004. This is an increase of 25 bp.

INFLATION INDICATORS AT JUNE
(PERCENTAGE CHANGE)

	Monthly			Year to Date			Annual		
	2002	2003	2004	2002	2003	2004	2002	2003	2004
I. CPI	0.4	(0.0)	0.6	4.8	5.0	4.6	6.2	7.2	6.1
Food	0.8	(1.1)	0.7	7.7	4.6	5.7	9.2	7.7	6.5
Housing	0.6	0.5	0.8	2.5	4.3	3.5	4.2	6.0	5.4
Clothing	0.2	0.2	(0.1)	0.4	1.1	1.2	1.1	1.4	1.6
Health care	0.8	0.5	0.6	6.4	6.3	5.7	9.7	9.1	8.0
Education	0.0	0.0	0.0	5.5	4.1	4.6	6.7	5.0	5.4
Culture and leisure	0.1	0.1	0.2	4.5	4.0	4.1	n.a.	4.8	5.3
Transportation	(0.2)	0.4	1.1	3.7	8.4	5.5	5.0	10.7	8.7
Sundry expenditure	0.4	0.4	(0.0)	6.2	5.3	3.9	6.8	8.1	4.3
II. Core Inflation 1/	0.3	0.4	0.6	3.8	5.5	4.1	5.3	7.2	5.8
Non-food CPI 2/	0.3	0.4	0.6	3.6	5.2	4.1	5.0	7.0	5.9
Core 3/	0.4	0.3	0.6	4.0	5.7	4.1	5.9	8.0	6.3
CPI excluding staple foods. fuel and public utilities	0.2	0.3	0.4	3.5	4.8	3.8	5.1	6.5	5.3
III. PPI	0.4	(0.2)	0.4	2.7	4.3	4.5	2.9	10.9	5.9
According to economic use									
Intermediate consumption	0.4	(0.2)	0.7	2.7	5.0	4.8	1.2	12.4	6.7
End consumption	0.1	(0.2)	0.0	2.8	3.5	4.2	4.6	8.0	5.0
Capital goods	1.3	(0.4)	0.2	2.3	2.1	0.7	2.8	15.4	1.7
Building materials	0.5	0.1	0.3	3.2	7.0	8.4	5.0	11.7	11.2
According to origin									
Produced and consumed	(0.0)	(0.1)	0.4	3.1	4.5	5.7	3.4	8.6	7.4
Imported	1.5	(0.4)	0.4	1.5	3.6	0.7	1.6	18.3	1.5
Exported 4/	2.1	(0.8)	0.2	9.2	0.9	4.3	(2.4)	18.7	5.7
According to industrial origin (CIIU)									
Agriculture. forestry and fishing	(0.6)	(1.3)	0.4	3.9	3.4	5.9	2.1	8.7	5.1
Mining	(0.8)	2.8	(1.8)	10.9	5.3	11.7	2.1	26.6	15.9
Manufacturing industry	0.6	(0.0)	0.4	2.2	4.5	3.8	3.2	11.1	5.7
20 items with the most imported components	0.1	0.2	0.4	4.7	8.7	5.1	8.6	13.6	7.6

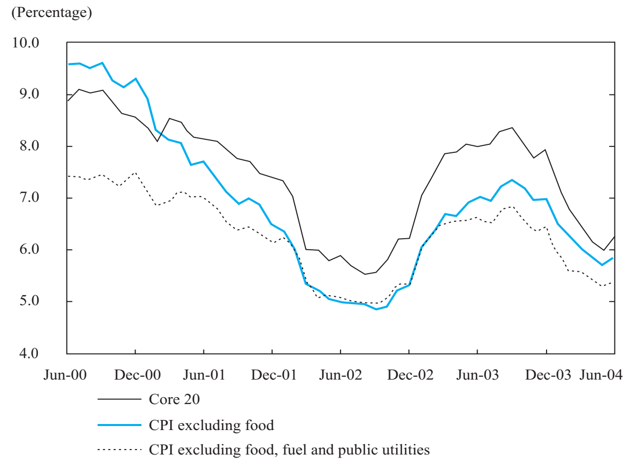
n.a. Not available.
1/ Average of the three core inflation indicators. Calculated by Banco de la República.
2/Excludes all food-group items from total CPI.
3/ Excludes from the CPI 20% of the weight of the items with the most price volatility between 1990 and April 1999.
4/Total PPI does not include exports. These are calculated with the weighed sum of produced, consumed and imported goods.
Source: Banco de la República, SGEE. CPI, PPI and DANE tabulations.

of the three indicators used most often (excluding food, core and excluding staple foods, public utilities and fuel) was 5.8% at June. This is 1.1 pp less than the rate in December (Figure 16).

The drop in core inflation was due to a sharp decline in tradable inflation resulting from a stable exchange rate in the second half of 2003 and appreciation at the end of last year. This more than offset the rise in international prices for some of the commodities imported by Colombia (Figure 17).

Figure 16

Core Inflation Indicators

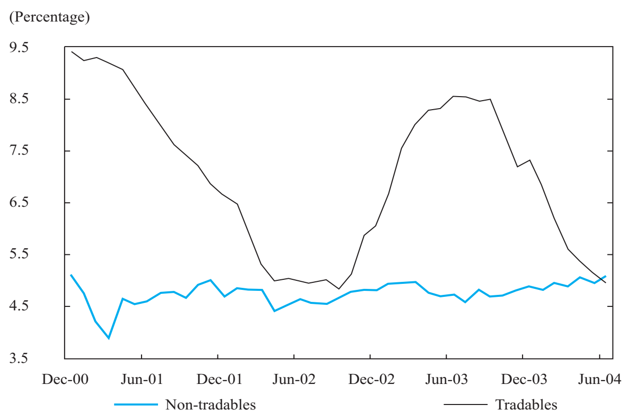


Source: Banco de la República.

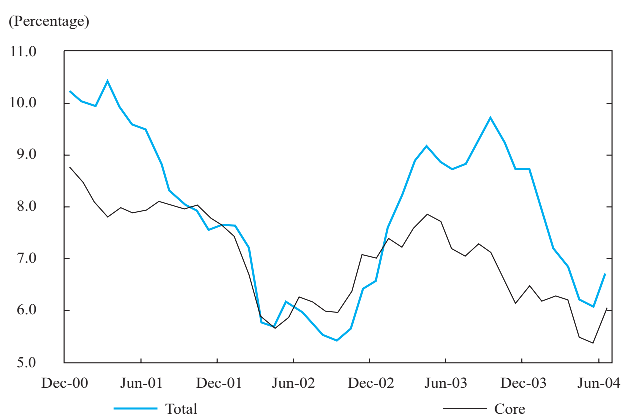
Figure 17

Annual CPI Inflation

Core CPI (*) for Tradables and Non-tradables



Total and Core Tradable Inflation



(*) Does not include food and regulated items.
Source: Banco de la República.

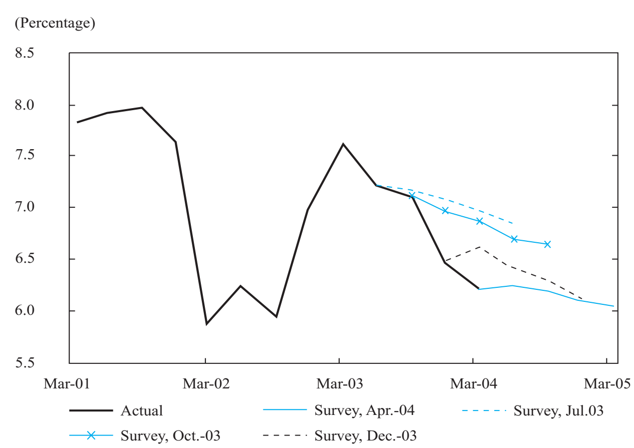
The trend in tradable inflation shows the transfer of devaluation registered between mid-2002 and 2003 was largely complete by March 2004. Tradable inflation (excluding staple foods and regulated prices) was 4.9% in June. This is similar to the rate in June 2002 (5.0%), when the devaluation phase started.

Non-tradable (core) inflation (excluding food prices and those for regulated goods and services) stabilized between 4.5% and 5.5%, although there was a slight rise because of the recovery in rental prices (Figure 17). In general terms, fewer expectations of inflation (Figure 18) and the surpluses in capacity that explain the limited inflationary pressures exerted by demand may have contributed to the stability in non-tradable inflation.

The positive trend in core inflation compensated for shocks from prices for staple foods and regulated goods and services, not all of which were fully anticipated. One of the more important unforeseen shocks was the increase in prices for certain staple foods-garden produce (not including potatoes) and primarily vegetables, the supply of which was below normal due to low prices at mid-year. Higher international prices for imported goods, especially fuels and foods such as cereals and edible oils, was another source of inflationary pressure.

Figure 18

Inflation Expectations



Source: Banco de la República.

The continued pressure on total inflation exerted by the prices of other regulated goods and services (fuel, transportation and public utilities) was similar to what was expected. Annual inflation for all these subgroups remained well above the target, but tended to decline throughout the year. Gasoline did the most to pull down inflation in this group, going from 17.6% annual inflation at December 2003 to 0.2% at June 2004. On the other hand, inflation in public transportation is up and was 10.1% in June.

B. Economic Activity

Growth continued to be stimulated, among other factors, by an expansive monetary policy...

The Colombian economy continued to recover rapidly in late 2003 and early 2004, compared with the previous five years. In the fourth quarter of 2003, annual growth was 4.9%, followed by 4.08% in the first quarter of 2004 and 4.24% excluding illicit crops (Table 14). This is primarily the result of private investment and exports, especially to Venezuela, which have made a strong comeback after the debacle in 2003.

A variety of external and domestic factors are responsible for the economic recovery. On the external front, the first months of 2004 saw added vitality in the world economy and a renewal of growth in Venezuela. This was accompanied by price increases for some of Colombia's main export products, besides those observed at the end of the previous year, which helped to improve the trade balance.

Growth on the domestic front continued to be stimulated, among other factors, by an expansive monetary policy. Its main success is having kept real interest rates on the market at historically minimum levels. There is also a growing climate of confidence that is beginning to compare with the results of business opinion polls in the mid-nineties.

...its main success is having kept real interest rates on the market at historically minimum levels.

The rise in growth was accompanied by an outright tendency towards appreciation in the exchange rate up until late March. Since then, the exchange rate has been extremely volatile. Besides the increase in exports during January-March, this appreciation was the result of a rise in net capita inflows. They were also a phenomenon in other Latin American economies, such as Chile and Brazil, and were associated with the existence of broad international liquidity, the market's low perception of risk, and a profitability differential favorable to investment in emerging economies. In May, however, the international financial markets discounted the increase in U.S. interest rates, prompting a certain turnaround in capital flows to the regio-

Table 14

Annual GDP Growth - Demand Side
(Percentage Change)

	2003 (pr)					2004 (pr)
	I	II	III	IV	Annual	I
Gross domestic product	4.2	2.5	4.2	4.9	3.9	4.1
Total imports	18.8	1.2	10.8	9.0	9.7	5.3
Total end supply	6.3	2.3	5.2	5.5	4.8	4.3
End consumption	1.6	1.3	1.7	3.6	2.1	4.0
Households 1/	2.0	1.4	2.4	3.4	2.3	4.6
End household consumption 2/	2.3	1.4	2.2	3.2	2.3	4.1
Non-durables	0.8	(1.5)	1.2	2.1	0.6	2.7
Semi-durables	1.6	4.1	1.9	4.7	3.1	6.7
Utilities	2.9	3.0	2.7	2.4	2.8	3.0
Durables	10.1	5.3	6.6	14.3	9.1	18.9
Government	0.3	0.8	(0.2)	4.1	1.2	2.2
Gross capital formation	49.1	5.2	16.4	14.3	19.4	9.0
Gross fixed capital formation	20.3	6.7	13.0	15.4	13.7	10.8
Agriculture. forestry. hunting and fishing	6.7	(0.4)	(9.1)	(2.1)	(1.4)	(2.2)
Machinery and equipment	24.5	11.3	23.9	26.2	21.6	12.0
Transportation equipment	64.2	(11.2)	(4.8)	(10.3)	3.9	(5.5)
Buildings	9.2	20.8	22.0	25.9	19.9	58.0
Civil works	22.1	(8.8)	(1.0)	0.4	2.6	(41.6)
Subtotal: End domestic demand	7.4	1.9	4.1	5.4	4.7	4.8
Total exports	0.4	4.6	11.7	6.2	5.6	1.1
Total end demand	6.3	2.3	5.2	5.5	4.8	4.3

(pr) Preliminary.
1/ Includes purchases of goods abroad by residents but not purchases in Colombia by non-residents.
2/ Pertains to end consumption in Colombia by resident households.
Source: DANE.

nal economies. Nevertheless, the situation has begun to stabilize in recent weeks and there has been some reduction in the risk premiums of Latin American countries.

According to the latest figures, economic activity worldwide should continue to gain force during the remainder of 2004. Current prospects are even better than what was expected three months ago. Although the forecasts for growth have been revised downward in the case of China, considerable expansion is still expected for the year (near 7.0%). There has been an important acceleration in the United States and Japanese economies, while economic growth in the Euro zone remains slow. Asia continues to expand at quite a fast pace. Prospects for growth in Latin America are above 4.0%. This is due to good prices for basic exports, despite the recent volatility of financial markets.

Coal, nickel and gold prices in the first quarter were above those registered during the final quarter of 2003. The international price of oil has surpassed all initial predictions, especially since March when it topped US$40 a barrel (WTI). The trend in prices for crude oil is the result of low reserves in the United States, the slow recovery in Iraq's production, and a strong demand in the United States and Asia. However, these prices are expected to decline throughout the rest of the year, thanks to a decision by the Organization of Petroleum Exporting Countries (OPEC) to alleviate high prices by increasing production. Nevertheless, the forecasts in recent months have been consistently below the actual price for this hydrocarbon.

The rate of growth for total exports was maintained in a context marked by high commodity prices and a momentum in demand worldwide (Figure 19). The positive performance of traditional exports is explained by the trend in foreign sales of coffee, petroleum, coal and ferro-nickel. For example, the National Federation of Colombian Coffee Growers reported an increase of 16.4% in the number of sacks exported in the first quarter of the year, compared with the same period in 2003. Coffee prices on the international market increases as well (by 4.42%). Foreign sales of ferro-nickel and coal benefited from higher export prices (91.0% and 10.0%, respectively), and the demand for coal in the European Union rose significantly.

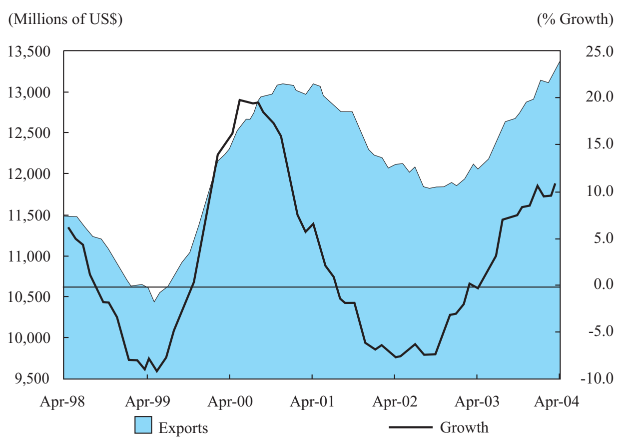
As to non-traditional exports, figures up to April show a recovery (Figure 20). Growth rates for non-traditional industrial exports to the United States and the other trading partners remain high. Sales to Ecuador appear to have hit bottom and those to Venezuela, as mentioned earlier, are recovering.

The positive way traditional exports performed throughout 2003 and the high exchange rate, in real terms, allowed production in the tradables sectors to recover. This was particularly true of mining (with 12.1% growth) and certain branches of the manufacturing industry, such as textiles, clothing and wood products.

Household consumption in the second quarter of 2003 and particularly the fourth benefited from low real interest rates, better economic conditions, the recovery in the leading job-market indicators, a lower perception of risk, and the growth in credit.

FIGURE 19

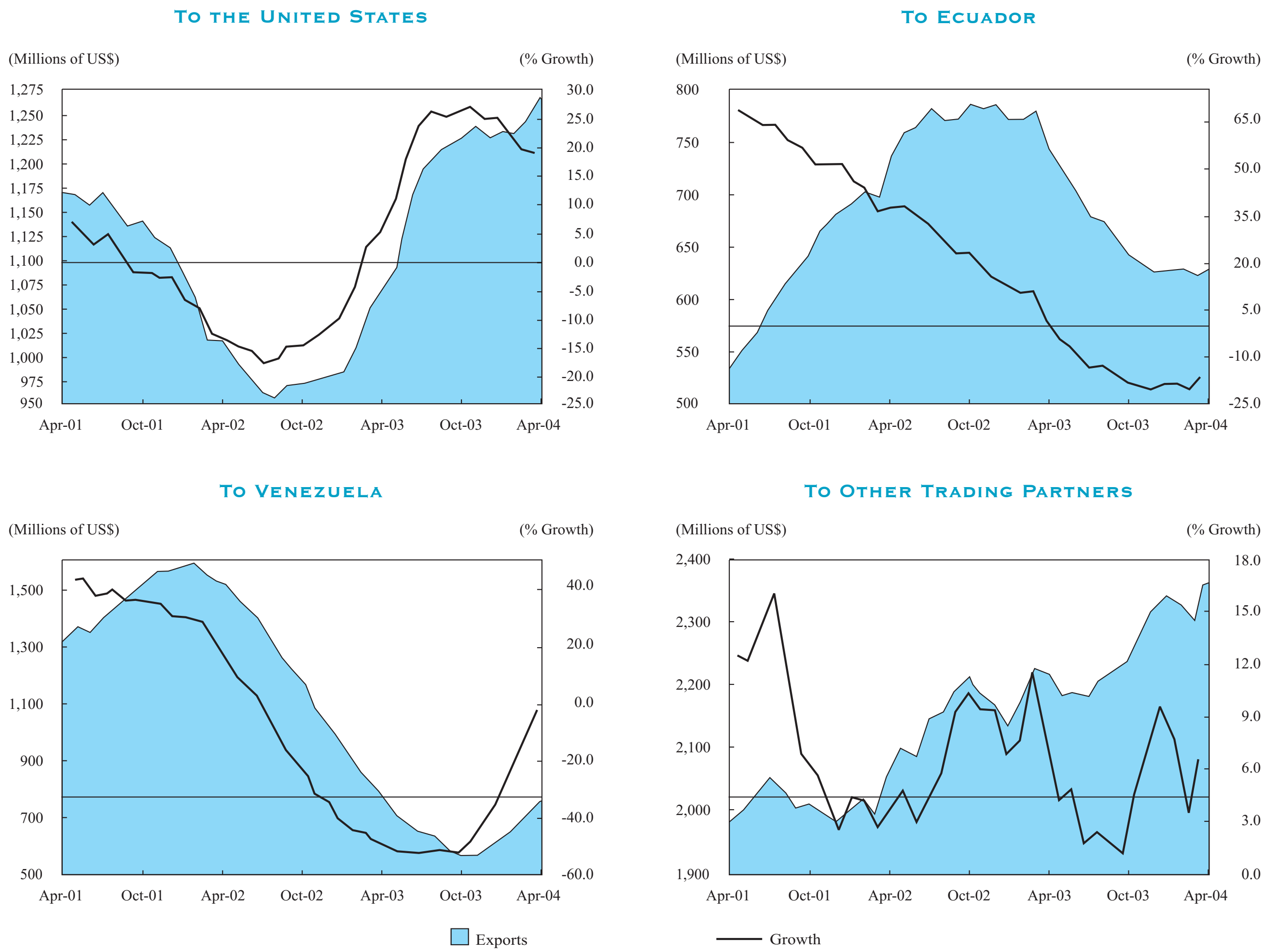
TOTAL EXPORTS (LAST 12 MONTHS)



Source: DANE.

FIGURE 20

NON-TRADITIONAL INDUSTRIAL EXPORTS (LAST 12 MONTHS)



Source: DANE.

These conditions remained in place during the first quarter of 2004. Meanwhile, the wealth effects continued to increase as a result of the reduction in the country-risk premium on the external debt, the favorable trend in stock prices, and the recovery in real estate prices.

Fixed investment rose considerably in 2003 (13.7%). This was due to a better opinion among businessmen about political and economic conditions for investment, as well as the recovery in the financial system, larger capital inflows and higher company profits. Increased access to other sources of financing (such as external funding) in the early part of the year was also a factor, as were tax incentives for reinvesting profits.[11]

[11] According to Article 68 in the last tax reform (Law 868 of 2003), taxpayers who are responsible for income tax may deduct 30% of the value of investments made to purchase real productive assets.

During the second half of 2003, the increase in domestic demand accelerated GDP growth and production in non-tradable sectors, particularly in the construction, commerce, transportation and financial sectors (Table 15). This expansion continued throughout the first quarter of 2004.

Given the international environment described earlier, the economy can continue to consolidate its recovery. Tradable sectors such as mining, agriculture and the manufacturing industry will benefit from a favorable external sector and could experience more growth during 2004 than in 2003.

Domestic demand will continue to perform according to the growth in investment, which is being propelled not only by confidence and better expectations, but also by increased use of industrial capacity in different sectors and by the positive effect the tax incentive might have on reinvestment of profits. This incentive is part of the latest tax reform.

In addition to investment, the current year should see a recovery in the rate at which consumption is growing. Household consumption is now expected to increase by about 3.4%, which is the highest rate since 1995. In this context, product growth for 2004 is forecast at 4.0% (Table 16). However, because of the persistent negative product gap mentioned in the previous section, product growth is not expected to translate into higher inflation for non-tradable goods and services.

Table 15

Annual Sectoral GDP Growth, including Illicit Crops
(Percentage)

	2003 (pr)					2004 (pr)
	I	II	III	IV	Annual	I
Agriculture, forestry, hunting and fishing	2.8	0.6	5.4	3.9	3.1	3.0
Mining and quarrying	0.8	18.6	21.0	8.7	12.1	5.6
Electricity. gas and water	2.1	3.9	3.6	3.6	3.3	4.5
Manufacturing industry	7.8	1.0	3.5	5.0	4.2	4.4
Construction	15.1	7.8	11.8	14.9	12.4	12.1
Commerce. repairs. restaurants and hotels	5.3	3.4	5.9	5.9	5.1	5.8
Transportation. storage and communication	5.1	3.2	4.0	5.8	4.5	6.4
Finan.. insurance. real estate and comp. serv. establishments	5.6	4.1	5.6	3.0	4.6	7.5
Social. community and personal services	0.6	0.9	0.3	3.1	1.2	2.0
Financial brokerage services. measured indirectly	14.4	15.3	25.5	2.9	13.9	29.0
Subtotal: Added Value	4.0	2.6	4.1	5.0	3.9	3.9
Gross Domestic Product	4.2	2.5	4.2	4.9	3.9	4.1

(pr) Preliminary.
Source: DANE.

TABLE 16

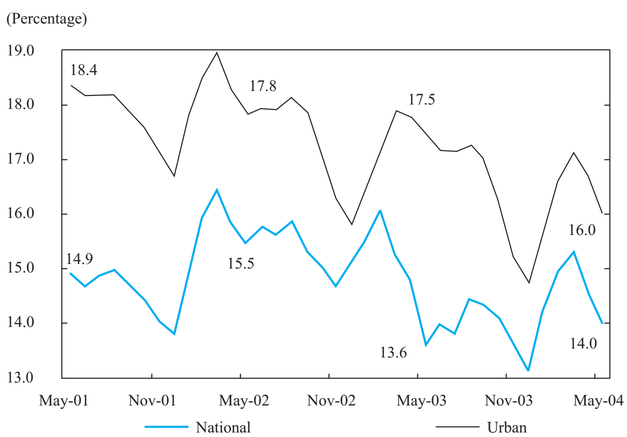
GROWTH PROJECTIONS: 2004
(PERCENTAGE)

	2001	2002 (pr)	2003 (pr)	2004 (proj)
Gross Domestic Product	1.5	1.8	3.9	4.0
Total Imports	6.8	0.3	9.7	6.4
Total End Supply	2.2	1.5	4.8	4.4
End Consumption	2.3	1.7	2.1	2.9
Household	2.7	2.0	2.3	3.4
Government	1.1	0.6	1.2	1.3
Gross capital formation	1.9	9.4	19.4	13.0
Gross fixed capital formation	8.5	9.2	13.7	8.7
Subtotal: End Domestic Demand	2.2	2.8	4.7	4.6
Total exports	2.4	-4.6	5.6	3.0
Total End Demand	2.2	1.5	4.8	4.4

(pr) Preliminary.
(proj) Projection.
Source: Banco de la República.

FIGURE 21

UNEMPLOYMENT RATE
THREE-YEAR MOVING AVERAGE



Source: DANE, Continuing Home Survey (ECH).

C. EMPLOYMENT

Information provided by the National Bureau of Statistics (DANE) for the period up to May shows unemployment has declined systematically since April 2001 (Figure 21). This reduction has been more pronounced at the urban level[12] than nationwide, which indicates the unemployment rate in other municipal seats and the dispersed rural area may not have changed.[13]

The decline in the urban unemployment rate is explained by positive performance in labor-intensive sectors such as construction and commerce. At the national level, the lesser reduction in unemployment contrasts with the increase in agricultural GDP without illegal crops. This sector grew at an average annual rate of 2.5% between 2000 and 2003, exceeding average growth for the economy as a whole during that same period (1.9%). Accordingly, the standstill in unemployment in the dispersed rural area cannot be attributed to performance in the agricultural sector.

[12] The term «urban» refers to information from DANE for the 13 major cities and metropolitan areas in Colombia.

[13] The national employment rate includes information from the survey of the 13 major cities, other municipal seats and the broad rural area.

Job creation has increased during the period from 2001 to 2004. At the national level, there were 1.2 million more employed individuals (equivalent to an increase of 7.5% during the period). At the urban level, 687,000 people found work (an increase of 9.7%). The unemployment rate during the same period in the 13 major cities went from 19.2% to 17.7%, and from 15.8% to 14.9% nationwide (Table 17). More importantly, the reduction in urban unemployment is due mainly to an increase in the employment rate (from 80.8% to 88.9%) and not so much to a decline in the overall participation rate.

Even though underemployment has been on the rise since 2001, available information points to a substantial improvement in the quality of employment during the past year. This is evident in the fact that fewer people classify as hourly underemployed, although the last two months have seen movement in the opposite direction (Figure 22).[14]

Another indicator of job quality is affiliation with the pension system for equitable individual savings. According to the Banking Superintendent, 890,000 people joined the system between 2002 and 2004. This is an increase of 19.9% (Figure 23). A look at the origin of affiliation shows that only 35,000 of all new members were transfers from the Social Security Institute; that is, people who had paid into the Social Security system before transferring to a private pension-fund management organization (AFP). The number of people entering the system who had not contributed previously to a pension fund increased by more than 800 thousand. This explains 90% of the new affiliations. The Federation of Family Subsidy Organizations (FEDECAJAS) reported that more than 14,000 new companies joined

[14] Because the rate of underemployment is measured with the findings of a qualitative survey, it is somewhat subjective. For example, a person is classified as underemployed if, among other factors, their present employment is considered inadequate for their skills, it is felt they could work more hours per day, or they do not earn enough. Underemployment by the hour is a better measurement. However, in Colombia, the rate of hourly underemployment in the rural area is not a reliable measurement, given the nature of the workday in the countryside.

Table 17

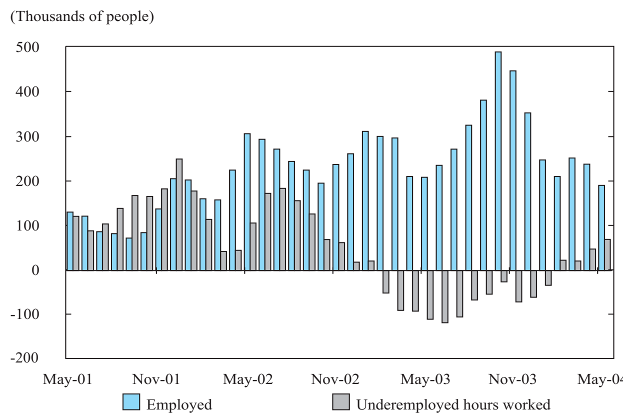
Employment, Unemployment and Underemployment Rates (Percentage)

	Employed	Unemployed	Under-employed	Underemployed by the Hour
National Total				
2001	84.2	15.8	29.1	13.6
2002	83.9	16.1	33.9	14.6
2003	85.3	14.7	30.2	11.4
2004	85.1	14.9	31.6	13.3
Thirteen Cities				
2001	80.8	19.2	29.1	13.2
2002	83.5	19.0	32.2	14.0
2003	86.7	18.6	32.7	12.9
2004	88.9	17.7	32.1	13.5

Method: The calculations are January-May averages for the respective populations.
Source: DANE, Continuing Home Survey (ECH).

Figure 22

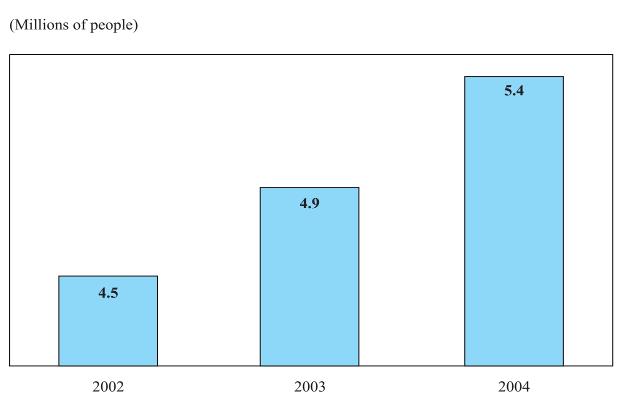
Job Creation - 13 Cities
Three-year Moving Average



Source: DANE.

Figure 23

Total Affiliates - Equitable Individual Savings System



Source: Banking Superintendent, press bulletins in April.

family subsidy organizations in the first quarter of 2004, and the number of workers who benefit from the services these organizations provide rose by 4.1% between 2002 and 2003 (up from 3.4 to 3.6 million people).

D. Balance of Payments

1. Balance of Payments in the First Quarter of 2004

In the first quarter of 2004, the balance of payments showed a current account deficit of US$722 million (-3.3% of quarterly GDP). This was financed with US$945 million in capital flows (4.3% of GDP) and US$ 197 million in other resources (errors and omissions). The accumulation in gross reserves (not including appreciation) came to US$420 million and the balance at March was US$11,332 million (Table 18).

a. Current Account

The current account deficit climbed to US$722 million between January and March 2004. This was due to the factor income deficit (-US$1,012 million) and the trade deficit for non-factor goods and services (-US$455 million). These negative balances were offset, in part by, net income from an estimated US$745 million in current transfers.

As to factor income, payments (US$89 million) exceeded those registered during the same period in 2003. This was because of interest on the external debt in the public sector, which increased by US$80 million, and to less return on reserve portfolio and private sector investments outside the country (US$22 million), primarily because of a stronger dollar against the euro and the yen, and the low profitability of external investments.

Although the trade deficit in the first quarter of 2004 was equal to the one registered a year earlier (US$64m), its composition was quite different. Table 19 summarizes export performance, by product, during the first quarter of 2004. External sales totaled US$3,258 million, including an increase of US$297 million (10.0%). The expansion in exports was due to more external revenue from ferro-nickel, coal, coffee and non-traditional products in the industrial sector.

Income from foreign sales of ferro-nickel rose by US$79 million owing to higher export prices (89.8%). This was in spite of the decline in export volume (2.0%).[15] Coal exports increased by US$76 million due to more

[15] Rising nickel prices on the international market are due to more world demand for this product on the part of China and Italy.

FIGURE 18

COLOMBIA'S BALANCE OF PAYMENTS - SUMMARY

	Millions of dollars			As a % of GDP			Difference 2004-2003
	2003 I Quarter (pr)	2004 I Quarter (e)	2004 Year (proj)	2003 I Quarter (pr)	2004 I Quarter (e)	2004 Year (proj)	US$ Millions
I. CURRENT ACCOUNT	(626)	(722)	(1,614)	(3.4)	(3.3)	(1.8)	(96)
Income	4,466	4,734	21,072	24.1	21.3	23.2	268
Outlays	5,092	5,456	22,686	27.5	24.6	25.0	364
A. Non-factor goods and services	(410)	(455)	(1,331)	(2.2)	(2.1)	(1.5)	(46)
1. Goods	(64)	(64)	335	(0.3)	(0.3)	0.4	0
Exports	3,142	3,360	15,167	17.0	15.1	16.7	218
Imports	3,206	3,424	14,831	17.3	15.4	16.3	218
2. Non-factor services	(345)	(391)	(1,666)	(1.9)	(1.8)	(1.8)	(46)
Exports	411	452	1,878	2.2	2.0	2.1	41
Imports	757	844	3,544	4.1	3.8	3.9	87
B. Factor income	(923)	(1,012)	(3,622)	(5.0)	(4.6)	(4.0)	(89)
Income	139	117	452	0.8	0.5	0.5	(22)
Outlays	1,062	1,130	4,074	5.7	5.1	4.5	67
C. Current transfers	706	745	3,339	3.8	3.4	3.7	39
Income	773	804	3,575	4.2	3.6	3.9	31
Outlays	67	59	236	0.4	0.3	0.3	(8)
II. CAPITAL AND FINANCIAL ACCOUNT	327	945	1,963	1.8	4.3	2.2	618
A. Financial account	327	945	1,963	1.8	4.3	2.2	618
1. Long-term financial flows	440	112	1,062	2.4	0.5	1.2	(328)
a. Assets	48	27	115	0.3	0.1	0.1	(21)
i. Colombian direct investment abroad	48	27	115	0.3	0.1	0.1	(21)
ii. Loans 1/	0	0	0	0.0	0.0	0.0	0
iii. Leasing	0	0	0	0.0	0.0	0.0	0
iv. Other assets	0	0	0	0.0	0.0	0.0	0
b. Liabilities	490	139	1,203	2.6	0.6	1.3	(352)
i. Foreign direct investment in Colombia	314	546	1,483	1.7	2.5	1.6	233
ii. Loans 1/	155	(380)	3	0.8	(1.7)	0.0	(535)
Public sector	594	(242)	638	3.2	(1.1)	0.7	(836)
Private sector	(440)	(139)	(636)	(2.4)	(0.6)	(0.7)	301
iii. Leasing	22	(27)	(282)	0.1	(0.1)	(0.3)	(49)
Public sector	4	(3)	15	0.0	(0.0)	0.0	(7)
Private sector	18	(24)	(297)	0.1	(0.1)	(0.3)	(42)
iv. Other liabilities	0	0	0	0.0	0.0	0.0	0
Public sector	0	0	0	0.0	0.0	0.0	0
Private sector	0	0	0	0.0	0.0	0.0	0
c. Other long-term financial movement	(2)	0	(26)	(0.0)	0.0	(0.0)	2
2. Short-term financial flows	(113)	833	902	(0.6)	3.8	1.0	946
a. Assets	304	(509)	(743)	1.6	(2.3)	(0.8)	(813)
i. Portfolio investment	247	(144)	(692)	1.3	(0.7)	(0.8)	(391)
Public sector	267	(300)	(314)	1.4	(1.4)	(0.3)	(568)
Private sector	(20)	156	(378)	(0.1)	0.7	(0.4)	176
ii. Loans 2/	57	(365)	(51)	0.3	(1.6)	(0.1)	(422)
Public sector	5	6	0	0.0	0.0	0.0	1
Private sector	52	(371)	(51)	0.3	(1.7)	(0.1)	(423)
b. Liabilities	191	324	158	1.0	1.5	0.2	133
i. Portfolio investment	(16)	94	0	(0.1)	0.4	0.0	110
Public sector	4	78	0	0.0	0.4	0.0	74
Private sector	(20)	16	0	(0.1)	0.1	0.0	36
ii. Loans 2/	207	230	158	1.1	1.0	0.2	23
Public sector	(230)	(81)	0	(1.2)	(0.4)	0.0	149
Private sector	437	311	158	2.4	1.4	0.2	(126)
B. Special capital flows	0	0	0	0.0	0.0	0.0	0
III, NET ERRORS AND OMISSIONS	28	197	0	0.1	0.9	0.0	170
IV. CHANGE IN GROSS INTERNATIONAL RESERVES 3/	(271)	420	349	(1.5)	1.9	0.4	691
V. GROSS INTERNATIONAL RESERVE BALANCE	10,620	11,332	11,258	11.7	12.5	12.4	711
VI. NET INTERNATIONAL RESERVE BALANCE	10,616	11,330	11,256	11.7	12.5	12.4	714
Months of merchandise imports	9.93	9.93	9.11				
Months of goods and service imports	8.04	7.96	7.35				
Nominal GDP in millions of dollars	18,502	22,188	90,870				
VII. CHANGE IN NET INTERNATIONAL RESERVES	(272)	424	353	(1.5)	1.9	0.4	695

2004 Assumptions; Export prices: Coffee US$0.75/lb. (exdock), petroleum US$34.61/barrel, growth in merchandise imports 11.9% (13.0% without Plan Colombia and Plan Fortaleza).
(pr) preliminary. **(e)** estimated. **(proj)** projected.
1/ Includes portfolio investment, direct loans and commercial credit.
2/ Includes direct loans, commercial credit and other assets and liabilities.
3/ According to the balance-of-payments method.
Source: Banco de la República.

Table 19

FOB Exports
By Principal Products and Economic Sectors (PR)
(Millions of dollars)

	January-March		Change	
	2003	2004	Absolute	%
Traditional exports	1,398.3	1,609.2	210.8	15.1
Coffee	190.6	232.0	41.4	21.7
Coal	246.0	322.2	76.3	31.0
Ferro-nickel	88.4	167.8	79.4	89.8
Petroleum and by-products	873.4	887.1	13.7	1.6
Non-traditional exports 1/	1,562.6	1,649.0	86.4	5.5
Agricultural sector	363.4	319.8	(43.5)	(12.0)
Industrial sector	1,064.2	1,175.3	111.1	10.4
Mining sector 2/	135.0	153.9	18.9	14.0
Total exports	2,961.0	3,258.2	297.2	10.0

(pr) Preliminary.
1/ Does not include temporary exports, re-exports and others. Includes balance-of-payment adjustments.
2/ Includes gold and emeralds.
Source: DANE and Banco de la República.

export volume (22.0%)[16] and better sale prices (10.4%). The first quarter of 2004 saw US$232 million in coffee exports. This represents 21.7% growth compared with the year before and was the result of more export volume (16.9%). The increase in international coffee prices (6.1%) was also a factor, but to a lesser extent.

Colombia exported US$887 million in hydrocarbons, or US$14 million more than during the same period in 2003. This variation is explained by the increase in exports of petroleum by-products (15.8%). However, crude exports fell by 3.5%. The drop in petroleum sales was due to less volume sold abroad (9.3%), but was offset in part by higher export prices, which went from an average of US$31.34 a barrel in 2003 to an average of US$32.70 a barrel at March 2004.[17]

Most non-traditional exports went to the regional market of the Latin American Integration Association (ALADI), which accounted for 37.5% of the total value of the goods exported in this group. Industrial products

[16] The increase is mainly due to larger volumes of coal required by the European Union.

[17] The drop in export volume was due to depletion of the country's largest fields. It is important to remember that international prices for crude oil rose steadily throughout the first quarter of 2004, topping US$35 a barrel by the end of the quarter. This trend is associated with low reserves in the United States, the slow recovery in Iraqi production and strong demand, particularly in the United States and Asia.

were in particular demand. The recovery in non-traditional exports to Venezuela, which rose by 130.5% (US$118 million), is another important factor (Table 20). Agricultural exports fell by US$44 million, especially bananas sold to the European Union and the United States.

The value of FOB imports rose to US$3,367 million during the first quarter of 2004. This includes an increase of US$225 million (7.2%) compared with the same period in 2003 (Table 21). Import growth is explained mainly by the higher costs of intermediate goods purchased abroad (US$217 million, 15.8%) particularly for the industrial sector. Imports of consumer goods rose by US$52 million (9.6%). This was due to more demand for private automobiles, machinery and home appliances. Capital goods declined by US$44 million (3.6%) owing to fewer purchases of transport equipment (US$150 million). This downturn was compensated, in part, by the growth in imports of industrial machinery and equipment (US$80 million).

b. Capital Account

The capital and financial account registered US$945 million in net income for the economy during the first quarter of 2004. This is US$618 million more than during the same period in 2003 (Table 18).

Table 20

U.S Dollar Value of Colombian Exports, by Country of Destination
(January-March 2004)
(Annual percentage growth)

	United States	Venezuela	Ecuador	Japan	Germany	Mexico	Others	Total
Total	5.0	109.2	9.0	26.5	32.3	12.5	4.6	10.0
Non-traditional exports	(0.9)	109.7	9.8	(7.4)	24.3	(5.7)	(7.2)	5.5
Agricultural sector	(11.4)	8.0	9.6	(0.3)	29.6	(46.6)	(21.5)	(12.0)
Industrial sector	8.3	130.5	(2.3)	(3.1)	14.2	(5.0)	(4.6)	10.4
Food. beverages and tobacco	17.8	89.5	(19.0)	(3.3)	55.5	107.0	(15.0)	6.5
Yarn. thread and fabric	35.7	635.0	21.2	n.a.	(18.2)	25.6	(11.5)	44.2
Clothing	15.4	71.6	23.9	n.a.	(30.4)	2.3	20.6	17.2
Plastic and rubber products	28.0	68.9	(4.9)	n.a.	0.0	(40.9)	26.0	7.5
Leather and leather goods	(6.3)	263.0	(11.4)	350.0	0.0	34.7	17.0	14.3
Wood and wood products	13.5	96.9	71.4	n.a.	(33.3)	1,053.8	(41.9)	(7.5)
Printing and publishing	(17.6)	65.8	3.0	8.8	(33.3)	(20.5)	(16.0)	(3.3)
Chemical industry	22.6	120.9	(3.6)	(29.4)	0.0	(14.5)	(2.0)	11.1
Non-metallic minerals	(31.2)	233.1	(8.6)	n.a.	n.a.	(38.5)	(25.8)	(20.7)
Base metal industry	22.4	113.1	(8.3)	(40.0)	14.3	(21.6)	14.7	18.2
Machinery and equipment	26.3	214.6	(5.3)	166.7	250.0	(28.8)	(17.2)	17.0
Transport material	(5.2)	672.4	(5.7)	0.0	50.0	(53.4)	(36.9)	61.6
Optical. cinema and other equipment	6.9	125.0	(23.4)	300.0	(16.7)	165.9	14.2	16.2
Other industries	15.7	78.0	63.6	(90.0)	(50.0)	7.8	26.7	30.1
Mining sector **(*)**	(3.5)	148.3	1,598.3	(15.4)	28.6	(75.6)	21.2	14.0

n.a. Not applicable.
(*) Includes gold and emeralds.
Source: DANE and Banco de la República

TABLE 21

IMPORTS (FOB), BY ECONOMIC USE (PR)
(MILLIONS OF DOLLARS)

	January-March		Change	
	2003	2004	Absolute	%
Consumer goods	545.7	598.0	52.3	9.6
Durables	246.3	291.5	45.2	18.4
Non-durables	299.4	306.5	7.1	2.4
Intermediate goods	1,375.2	1,592.6	217.4	15.8
Fuel and lubricants **(*)**	64.3	62.1	(2.2)	(3.4)
For agriculture	119.7	135.3	15.6	13.0
For industry	1,191.2	1,395.2	204.0	17.1
Capital goods	1,218.6	1,174.5	(44.1)	(3.6)
Building materials	37.7	61.8	24.1	63.9
For agriculture	10.1	12.0	1.9	18.8
For industry	625.4	705.4	80.0	12.8
Transport equipment	545.4	395.3	(150.1)	(27.5)
Unclassified goods	1.8	1.4	(0.4)	(22.2)
Total imports	3,141.3	3,366.5	225.2	7.2

(pr) Preliminary.
(*) Includes petroleum and coal by-products.
Source: Bureau of Internal Revenue and Customs (DIAN) and DANE.

Net foreign direct investment[18] came to US$519 million, which is US$245 million in excess of the amount registered during the same quarter in 2003. As to sectors, most direct investment in Colombia went to mining and quarrying (US$312 million), petroleum (US$102 million) and manufacturing and finance (US$43 million and US$33 million, respectively).

The flow of long-term financing in the public and private sectors, including leasing, was -US$245 million and -US$163 million, respectively. The public sector reduced its net foreign liabilities by US$843 million with respect to the first quarter of 2003, while net foreign borrowing in the private sector rose by US$259 million.

Most external financing for the public sector was obtained through bond sales on the international market (US$500 million), loans from multilateral agencies and commercial banks (US$136 million), and debt instruments purchased by foreign funds (US$78 million). Payment on the external debt in the public sector was primarily for loans and bonds: US$528 million and US$419 million, in that order. The private sector received US$568 million in loan disbursements, which is US$116 million more than during the same period in 2003, while amortization declined by US$64 million. In keeping with economic growth and the trend in imports, the private sector obtained US$84 million in commercial credit.

[18] Foreign direct investment in Colombia, minus direct investments by Colombians outside the country.

Short-term capital flows registered US$833 million in net income. This is in sharp contrast with the US$113 million in net outflows abroad reported for the same period in 2003. The money coming into the country in 2004 is mainly from the increase in short-term borrowing by the private sector (US$311 million) and the liquidation of public-sector investments abroad (US$300 million).

c. Change in International Reserves

The movement in capital and goods and services during the period from January to March 2004 led to a gross accumulation of US$ 420 million in international reserves, excluding appreciation. The international reserve balance rose to US$11,332 million, which is equivalent to 9.9 months of merchandise exports, 8.0 months of goods and service imports, and 1.4 times the value of amortization on the public and private debt with one-year residual maturity.

2. Outlook for the Balance of Payment in 2004

According to current projections for the balance of payments in 2004, the current account deficit will amount to US$1,614 million (1.8% of GDP) and be financed with US$1,963 million in anticipated capital earnings (2.2% of GDP) originating with long- and short-term net capital inflows (US$1,062 million and US$902 million, respectively) (Table 18).

The estimate for the current account includes an anticipated rise of 14.5% in exports (excluding special commercial transactions), particularly foreign sales, in dollars, of products such as ferro-nickel (37.4%), coal (27.0%), petroleum and its by-products (22.2%), coffee (13.2%) and non-traditional items (8.2%). In addition, merchandise imports are expected to increase by 11.9% in response to further economic growth.

As to capital transactions, the country expects US$1,367 million in net foreign direct investment flows and US$653 million in net long-term foreign borrowing by the public sector. This includes leasing. The projection is for US$933 million in net payments on the long-term debt in the private sector. The trend in short-term flows would be explained primarily by the liquidation of private and public-sector investments outside the country (US$378 million and US$314 million, respectively), particularly those owned by the government and by the Petroleum Savings and Investment Fund (FAEP).

Box 1

The Minimum Wage as a Redistributive Tool

In most countries of the world, the fundamental objective of a minimum wage (MW) is to guarantee the worker and his family a basic standard of living. However, the end result of introducing or changing a MW is ambiguous for the employment rate, the unemployment rate and the redistributive impact of an MW in favor of the poorest households. This is aside from the other distorting effects on the decisions companies make in response to their factor demands, the decisions workers make in terms of looking for a job, joining the labor market and the formation of human capital, and the effects on macroeconomic balances. This is why determination of a minimum wage sparks strong debate among the groups who have an interest at stake and its assessment, as a tool in the fight against poverty, is an empirical task.

In most countries of the world, the fundamental objective of a minimum wage is to guarantee the worker and his family a basic standard of living. However, when it comes to defining or increasing its level and who the beneficiaries will be, little is known about its distorting effects on the job market and on living conditions for the poorest groups.

As Richard B. Freeman[1] so aptly states: "The distributive effects of the MW depend on the job market and the distributive system in which it operates, as well as the level of the MW and its observance. In the best of cases, the MW improves income distribution in favor of low-income workers. In the worst of cases, minimum wages reduce the share of income that goes to the poorest paid, leaving many people unemployed. Neither of these outcomes is certain."

With a model where the job market is divided between a sector that is covered by the MW and one that is not, and where agents operate in perfect competition, an increase in the MW tends to reduce employment in the covered sector by raising costs and, hence, the end price of goods. The result is fewer sales and less employment. In the long run, this effect is even greater, since the demand for jobs become more elastic due to increased substitution of capital for work.

The larger number of unemployed in the sector covered by the MW is divided among those who continue to look for work in the covered sector, those who move to the uncovered sector, and those who prefer to remain inactive. The larger supply in the uncovered sector leads to lower wages and a higher rate of employment in this sector. As a result, the ultimate effect on total employment depends on how it responds to the wage in both the covered and uncovered sectors and the extent of change in the MW.

Those who win with an increase in the MW are the ones who keep their jobs in the covered sector.[2] The losers include those who lose their jobs, the intensive consumers of goods produced by the covered sector, which are now

1 Freeman R. (1996). «The Minimum Wage as a Redistributive Tool,» in *Economic Journal*, No. 106, May, pp. 639-649.

2 This includes not only those who earn just the MW, but also those who earn more, because they are tied to the MW by the wage curve.

more costly, and the companies that face less profit. The workers who were employed in the uncovered sector also lose because their wages are reduced by the increase in the supply of manpower in this sector.

With this model, the total income of workers in the covered sector increases, provided the elasticity or response to the MW in this sector from the demand for labor is less than one. In this case, the higher income from the new MW for those who keep their jobs exceeds the reduction in income for those who lose their jobs. On the other hand, workers in the uncovered sector earn less if employment-to-wage elasticity is less than one, since less income from the drop in wages due to an increase in supply exceeds the increased income from additional employment in this sector.

However, not all hiring is the result of competitive markets. The MW improves the earnings of workers who are covered by law in imperfect markets where the company is a monopsony, either because it is the only employer on the market or because there are frictions associated with the process of looking for work. In this case, the company pays wages below the marginal productivity of the work and hires a quantity of manpower below that of perfect competition. As a result, the MW acts as a regulated price to equate the wage to marginal productivity, prompting the company to produce with a higher level of employment and income for its workers.

When companies are required to generate incentives and to incur the cost of monitoring to guarantee an adequate level of effort on the part of their workers, the MW can produce more jobs and income, as predicted by the theory of efficient wages. In this case, there is a positive correlation between wages and productivity, as the effort expended by workers (due, among other reasons, to better nourishment and health) is associated with what they earn. In this sense, the imposition of a MW can increase the productivity of low-income workers, heightening the company's demand for labor.[3]

The MW not only affects the demand for labor but supply-side decisions as well. First of all, some of those who lose their jobs in the formal sector may prefer to remain inactive rather than to accept the wages offered in the uncovered sector. The reduction in relative wages from skilled to unskilled can prompt those who are more skilled to reduce the number of hours they work. Job hunting episodes in the covered sector can increase, resulting in a larger number of discouraged workers. A situation where the household head loses his/her job or begins to earn less can prompt other members of the family group to enter the labor market.

As in any regulated market, companies and workers look for ways to avoid the MW, whether through new means of hiring or by "informalizing" the productive activity. In this way, the potential benefits of the MW are eroded in a kind of Laffer curve[4] and added distortion is introduced into the economy, reducing its potential for growth[5] by making it more informal.

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[3] 3The same argument is used in the model where the company must monitor individual effort. With an increase in earnings through the MW, some workers will be motivated to improve their performance and the company will be able to free resources used for monitoring to hire more workers.

[4] The Laffer curve was devised originally in reference to the effect of tax rates on tax collection. As of a certain point, higher tax rates reduce rather than increase tax collections.

[5] Loaiza, N. (1996). "The Economics of the Informal Sector: A Simple Model and Some Empirical Evidence from Latin America," in *Carnegie-Rochester Conf. Series Public Policy,* No. 45, pp. 129-162.

The ultimate impact on household well-being depends on the individual impact for each household member, but also on the decisions of the family group, particularly with respect to participation in the job market, investment in human capital (leaving school), and provision of goods and services within the family ("social security" for senior members).

Therefore, the final outcome of introducing or modifying a MW is uncertain with respect to the employment rate, the unemployment rate and the redistributive impact in favor of poor families. This is aside from the other effects (positive or negative) that might be derived from the decisions companies make in response to their factor demands, what workers decide in terms of looking for a job or joining the labor market, and the effect on macroeconomic conditions. This is why determination of a minimum wage sparks strong debate among the groups who have an interest at stake and its assessment, as a tool in the fight against poverty, is an empirical task (See Box 2).

Box 2

Empirical Evidence of the Redistributive Effect of a Minimum Wage

Minimum-wage laws are based on the principle of equity and shoring up the income of the poorest. International evidence, based primarily on developed economies where the minimum wage (MW) affects only specific segments of the job market (young workers), seems to indicate that its impact on employment is not significant or is slightly negative. However, if the objective is to alleviate economic conditions for the poorest, this diagnosis is incomplete. Recent studies show that most minimum-wage employees are single and have no children, or belong to families with favorable economic conditions where they are not the chief breadwinners.

In contrast, evidence for the developing countries shows mixed results. While some studies report a reduction in the poverty level due to increases in the MW, but only in times of increased activity, others encounter this same outcome, but in times of recession. Most recently, Saget (2001)[1], in a panel of developing economies, found that, when controlled by level of development, average wage and location, the MW tends to reduce national poverty levels.

Furthermore, in some Latin American countries, the MW plays an important numerical role in setting wages, by creating a spill over effect for workers who earn more than the minimum wage and for those who earn less, especially in the informal sector ("El farol" effect).

The tremendous potential of the MW for molding the distribution of wages is particularly marked in the Colombian case, where the existence of a MW affects the distribution of individual income by displacing part of those who earn less than the MW to levels equal to or above it. However, there is also evidence of a significant negative effect on employment. The ultimate impact of the MW on the welfare of the poorest households will depend on the

[1] Saget, C. (2001). «Is the Minimum Wage and Effective Tool to Promote Decent Work and Reduce Poverty? The Experience of Selected Developing Countries,» *International Labour Office Employment,* No. 13, International Institute for Labour Studies, Geneva.

occupational composition of its members and the sensitivity of their job situation - in terms of both income and occupation - to changes in the MW.

Studies on the MW in Colombia focus on its relationship to employment and inflation. Not much has been done to examine its effects on individuals or families. Bell (1997)[2] found the MW has a negative impact on unskilled labor, with 0.2 to 1.22 elasticity. Hernández and Lasso (2000)[3] found -0.43 elasticity for work by the young (even when not significant). Robbins (2003)[4] shows that either the MW has no significant impact on unskilled jobs or in some of his estimates the effect is positive. Unfortunately, his econometric study for the period from 1976 to 2002 includes the active interest rate, which is a poor approximation of the cost of the use of capital for the period in question.[5]

Maloney and Núñez (2001)[6] found the MW raises individual earnings but also the likelihood of losing a job, not only for individuals around the MW but also for those whose wages are above and below the minimum and for workers in the informal sector. Based on these estimates, Ángel-Urdinola and Wodon (2003)[7] calculated that the regressive effects associated with job loss exceed the progressive effects related to the wage gains, causing greater inequality.

Arango and Pachón (2004)[8] focus on what is perhaps the most important reason for defending the concept of a MW, despite its possible distorting effects on the labor market: its impact on the earning of the poorest households. Unmarried offspring, people who are separated or widowers, and other relatives of the household head are the human groups in Colombia with the highest relative share of individuals who work for near-minimum wages. In terms of age, it is the 12-to-19 and 20-to-24 age groups who have a larger share of minimum-wage earners. In terms of educational level, it is those who do not have a high school education. More importantly, when assessing the benefits of the MS as a mechanism for improving the well being of the poorest households, it is important to bear in mind that households of this type have a low relative percentage of individuals who earn approximately the minimum wage and more members who work in the uncovered sector. By the same token, it is the lowest income sectors where a large percentage of household heads work in the uncovered sector, are unemployed, do not earn a wage or work independently, which means they can not benefit from the MW. This being the case, it is not immediately clear as to whether the MW might benefit the poorest families.

Using panel data for the seven major cities between 1984 and 2001, Arango and Pachón (2004) found the MW had a positive effect on household income. However, this is only significant for households in the middle and upper per

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2 Bell, Linda A. (1997). "The Impact of Minimum Wages in Mexico and Colombia," in *Journal of Labour Economics,* Vol. 15, No. 3, pp. 103-135.

3 Hernández G.; and Lasso F. (1999). "El efecto del salario mínimo sobre el empleo," Mimeograph, National Department of Planning, Colombia.

4 Robbins, Donald J. (2003). "Empleo y desempleo en Colombia. El impacto de la legislación laboral y de las políticas salariales (1976/1999)," Economic documents, School of Economics, *Pontificia Universidad Javeriana,* No. 8.

5 During the period from 1975 to 1985, the financial system experienced extreme financial deregulation and financial instruments such as certificates of deposit emerged, considerably raising the level of competition among financial institutions.

6 Maloney, W.F., and J. Núñez (2001). "Measuring the Impact of Minimum Wages: Evidence from Latin America," in Heckman J.; Pagés, C. (eds) *Law and Employment: Lessons from Latin America and the Caribbean.* Cambridge, Mass. And Chicago, Ill., National Bureau of Economic Research and the University of Chicago.

7 Ángel-Urdinola, Diego F.; Wodon, Quentin (2003). "The Impact on Inequality of Raising the Minimum Wage: Gap-narrowing and Reranking Effects," in *Archivos de Economía, DNP*, No. 204.

8 Arango, Carlos A.; Pachón, Angélica (2004). "Minimum Wage in Colombia: Holding the Middle with a Bite on the Poor," in *Borradores de Economía, Banco de la República*, No. 280.

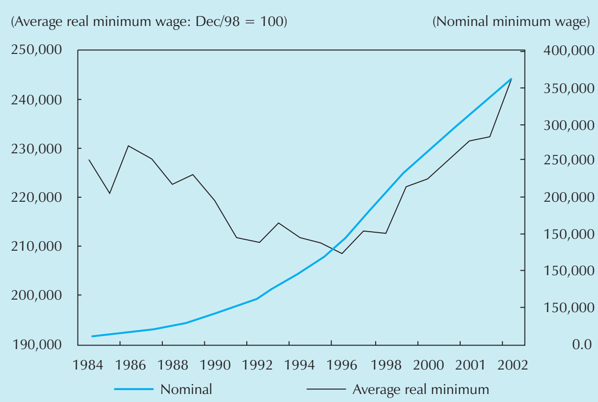
capita family income brackets. Accordingly, the MW has an important distributive effect that proves to be regressive by broadening the gap between the poorest families and those in other income brackets. The same authors found the MW has a negative impact on possibilities for employment and the hours worked by household heads. This is more pronounced among young people and women who head households, and explains why the net effect of the MW on families in the lowest income bracket is null, as opposed to positive net gains for families in the middle and upper income brackets.

Apart from the household head, other family members see their participation rate increase, particularly in families with little or no education. This modifies other labor dimensions of the family group, with their potential impact in terms of children dropping out of school and a poorer quality of life for the elderly.

Despite its effect on employment and its asymmetric impact on household income, evidence suggests the MW tends to improve economic conditions for 80% of the families. If we consider that more than 50% of the families in Colombia are below the poverty line, the MW helps to reduce poverty, in spite of generating more inequality among the poorest, benefiting families above the poverty line, and distorting the decision of the family group to participate in the job market. However, as confirmed by Arango and Pachón *Op. Cit.*, the MW plays an important numerical role in determining earned income by affecting the mean wage of the entire economy. This places a clear limit on this instrument. If it grows at rates that are incompatible with the increase in average productivity, it will lead to a loss of competitiveness, revaluation of the real exchange rate, higher unemployment and more informality in the economy, which will compromise growth and well being.

This becomes especially relevant when considering the real gains registered for the MW in Colombia since the nineties. As the following graph illustrates, the real increase in the MW between 1996 and 2004 was 2.0% a year, on average, even though the increase in average productivity per worker was only 0.3% a year during the same period.

NOMINAL AND REAL MINIMUM WAGE IN COLOMBIA: 1984-2004 (*)
(PESOS)



(*) Annual average of monthly data. Real wage deflected by the total CPI.
Source: Calculated by Banco de la República.

IV. The Level of International Reserves

Interest rates in the developed economies have been on the decline since 2000, which means higher prices for fixed-income assets.

A. The Current Level of International Reserves and their Management Criteria

Colombia had US$11,587.8 million in net international reserves[19] at June 2004,[20] which is US$672.2 million more than the balance reported at December 2003. The investment portfolio accounts for the bulk of these reserves: 90.2% (US$10,452.8 million). The rest include (i) the reserve position with the IMF and the Latin American Reserve Fund (FLAR), US$739.3 million; (ii) US$169.0 million in special drawing rights (SDR); (iii) US$152.1 million in gold, Andean pesos and positive balances from international agreements; and (iv) US$78.3 million in demand deposits and cash. External short-term liabilities stood at US$3.6 million at June 2004 (Table 22).

The three criteria used by Banco de la República to manage international reserves are security, liquidity and profitability, in that order. Based on these standards and to be sure the country is able to honor its external liabilities, reserves are invested in financial assets on a broad secondary market, while a portion are kept as working capital to guarantee immediate availability.

Pursuant to these guidelines, external financial institutions are appointed to manage a portion of the portfolio in which the country's international reserves are invested. These institutions are scrutinized carefully and selected according to their business experience, the size of the funds they manage, and the extent of their management and risk-control capacity. As

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19 Equal to total international reserves, or gross reserves, minus the Bank's short-term external liabilities, which are comprised of sight liabilities in foreign currency with non-resident agents.

20 Provisional figures.

Table 22

Principal Components of Colombia's International Reserves
(Millions of dollars)

Description	June 2003	Share %	December 2003	Share %	June 2004	Part. %
Cash	63.6	0.6	77.9	0.7	78.3	0.7
Cash on hand	63.0	0.6	77.2	0.7	77.6	0.7
Demand deposits	0.6	0.0	0.7	0.0	0.7	0.0
Investments	9,443.8	89.9	9,770.5	89.5	10,452.8	90.2
Direct portfolio	4,297.7	40.9	4,519.3	41.4	5,207.4	44.9
Managed portfolio	5,146.1	49.0	5,251.2	48.1	5,245.4	45.3
Gold	112.8	1.1	136.4	1.2	128.7	1.1
On hand	0.0	0.0	0.0	0.0	0.0	0.0
In trust	112.8	1.1	136.4	1.2	128.7	1.1
IMF	560.6	5.3	597.2	5.5	588.1	5.1
SDRs	160.2	1.5	172.5	1.6	169.0	1.5
Reserve position	400.4	3.8	424.7	3.9	419.0	3.6
FLAR	323.8	3.1	333.3	3.1	340.2	2.9
Contributions	303.8	2.9	313.3	2.9	320.2	2.8
Andean pesos	20.0	0.2	20.0	0.2	20.0	0.2
International Agreements	0.3	0.0	6.0	0.1	3.4	0.0
Total Gross Reserves	10,504.8	100.0	10,921.4	100.1	11,591.4	100.0
Short-term Liabilities	5.0	0.0	5.8	0.1	3.6	0.0
International agreements	0.0	0.0	0.0	0.0	0.0	0.0
Foreign banks	0.0	0.0	0.0	0.0	0.0	0.0
FLAR	0.0	0.0	0.0	0.0	0.0	0.0
Securities payable to purchase investments	0.0	0.0	0.0	0.0	0.0	0.0
Interest accrued on liabilities	5.0	0.0	5.8	0.1	3.6	0.0
Total Net Reserves	10,499.8	100.0	10,915.6	100.0	11,587.8	100.0

Source: Banco de la República.

mentioned in previous reports, the efforts of these institutions have improved the profitability of international reserves through specialized management

In terms of the investment portfolio as a whole, Banco de la República directly managed US$5,207.4 million (49.8% of the total investment tranche), including US$528.0 million in working capital. Barclays Global Investors, J.P. Morgan Investment Management Inc., Goldman Sachs Asset Management and Morgan Stanley Investments L.P. managed the other 50.2% (US$5,245.4 million).

During the first quarter of 2004, the reference index used to evaluate management of the portion of Colombia's international reserves[21]

[21] Known as the «global mandate».

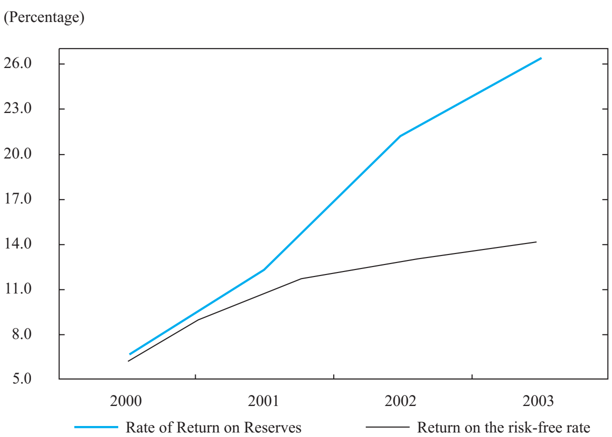
administered by Barclays Global Investors and J.P. Morgan Investment Management Inc. showed a return of -0.35% [22] as opposed to -0.61% and -0.38% profitability for each of the managing institutions. The reference index[23] for the portfolio managed by Goldman Sachs Asset Management and Morgan Stanley Investment L.P. showed a return of 0.04% compared with 0.34% for the former and 0.28% for the latter. The segment of the portfolio managed by Banco de la República (not including working capital) had yielded -0.01% by June 2004 compared with 0.02% for the reference index used to evaluate management of this portion.[24] The return on working capital was 0.47%.

The credit risk for the investment portfolio as a whole is concentrated mainly in the sovereign sector, including short and long-term holdings, with 60.5% of the portfolio. The rest is distributed among the other sectors; namely, 25.7% in the banking sector, 12.2% in the corporate sector and 1.6% in the supranational sector. At June 2004, distribution on the basis of credit quality according to ratings by specialized agencies[25] was as follows: 42.0% P-1,[26] 51.8% AAA, 5.8% AA and 0.4% A. The distribution of credit risk reflects the security with which international reserves are managed.

Interest rates in the developed economies have been on the decline since 2000, which means higher prices for fixed-income assets (See Box 3). During the 2000-2003 period, this was of considerable benefit to the securities in which reserves are invested. Foreign exchange appreciation against the U.S. dollar during that same period was also a factor. The combination of these two phenomena made the return on international reserves during this period unusually high, well above what was forecast by the Bank and above the return on the risk-free rate in the United States.[27] Figure 24 illustrates the accumulated rate of return on reserves compared with the risk-free rate in dollars. Figure 25 shows a breakdown of

Figure 24

Accumulated Rate of Return on Reserves vs. the Risk-free Rate in Dollars



Source: Banco de la República.

22 Effective, unanualized rates for the period. These are provisional figures subject to revision.

23 Known as the "rotation mandate in the United States". These are provisional figures subject to revision.

24 The reference portfolios used to measure the performance of external managers are comprised of assets denominated in U.S. dollars, euros and yen. These assets are invested in a combination of money-market instruments and government bonds at one to five years. At June 30, 2004, average duration of the total investment tranche index was 1.13 years and the foreign currency composition was 85% U.S. dollars, 12% euros and 3% yen.

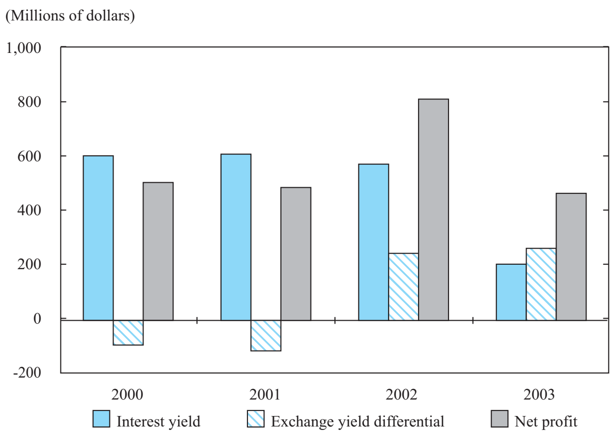
25 Standard & Poor's, Moody's and Fitch ratings.

26 On the short-term rating scale, "P-1" is the best.

27 The risk-free rate is the one obtained by the investor when neither market nor credit risks are assumed. In the case of the United States, the three-month treasury bill is used.

Figure 25

Yields on International Reserves 2000-2003



Source: Banco de la República.

the return on reserves in dollars from accruals and valuations of their fixed-income instruments ("interest yield") and from the exchange differential against U.S. dollars ("exchange yield differential").

During the 2000-2003 period, the yield achieved due to the policy adopted by Banco de la República on investment of international reserves was more than 85% of what was generated by the risk-free rate in dollars during the same period. The result was nearly US$1,190 million in surplus profits. The appreciation in fixed-income assets and the interest earned on those investments are the main sources of these surplus returns. Figure 25 shows that the yield on interest rates between 2000 and 2002 was approximately US$600 million a year, while income from the exchange differential had no significant impact on the total yield. In 2003, due to low interest rates the world over, the return on interest fell to a third of what it had been in previous years, while the appreciation in foreign currencies against the dollar, particularly for the euro and the yen, had a positive impact by offsetting the drop in interest rate returns.

The return on investments of reserves during the course of the year reflects the recent change experienced by international markets in terms of the direction of interest rates and the rate of foreign exchange against the dollar. The first quarter of 2004 witnessed several events that caused participants in the market to anticipate the rise in interest rates by the Fed, which initiated in June 2004. To begin with, employment growth in the United States was the best in almost four years. Secondly, the downturn in inflation came to a standstill and the sharp hikes in prices for electricity and raw materials signal possible inflationary pressure in the future. The Fed raised its base rate to 1.25% on June 30, 2004. This is an increase of 0.25%.

According to recent indications by the Fed, the United States economy is exhibiting strong growth and deflationary pressures have been dispelled. Expectations of an increase in rates have had an extremely negative impact on fixed-income instruments the world over. The yield on two-year government bonds in the United States rose by 0.84% during the year to date (Figure 26). This rise has lowered the market value of securities. The two-year interest rate in Germany has increased by just 0.12%, signaling a certain amount of stability in the market. This trend is due primarily to the moderate pace of economic growth in Europe during the current year. On the other hand, the euro was weaker against the dollar by 3.1% in the first half of 2004, due to prospects of a better return on investments in the United States, as European growth has lagged behind solid economic growth in the United States. The Japanese yen fell by 0.9% against the dollar during the present year. Consequently, investments denominated in these currencies have lost value in face of the dollar. This effect has been magnified by the general rise in interest rates in the developed economies.

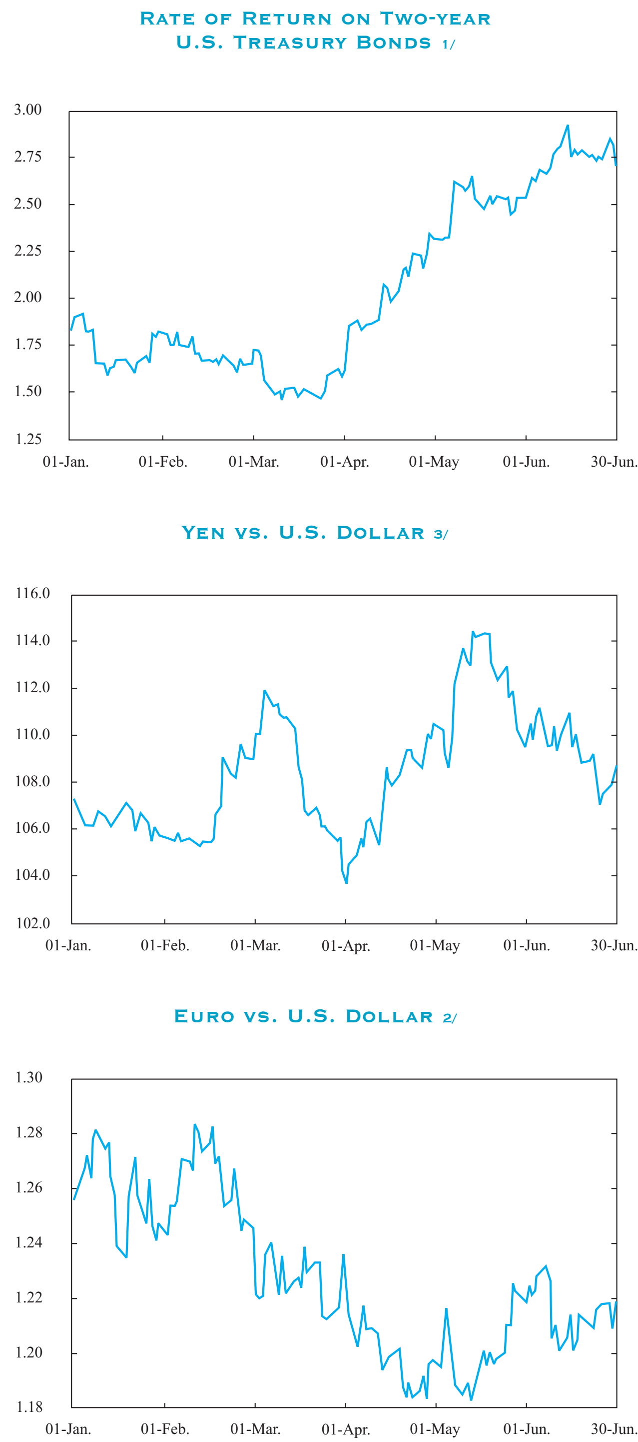
The net yield obtained by Banco de la República and the delegated managers on the investment portfolio for international reserves totaled -US$6.4 million at June 30, 2004. Accrued income came to US$121.3 million, but was offset by losses (-US$127.7 million) derived from valuation at the market prices of international reserves. The valuation losses originated with the trend in the euro, the yen and SDRs against the dollar (-USA$54.0 million), and with the devaluation of investments in bonds and the drop in gold prices (-US$73.7 million).[28] It is important to remember that Banco de la República increased the reserve for currency fluctuation to 730 billion pesos in 2003 to wipe out possible exchange losses in 2004.

Banco de la República has an extensive structure to control international reserve investments. There are internal controls as well. For example, the Bank is audited by two different sources: (i) Deloitte & Touche, a firm of outside auditors engaged for this purpose in 2002, and (ii) an audit commissioned by the President of Colombia.

Among the controls inherent in the Bank's audit of international reserve investments, the following are the most prominent. (i) Investment operations are monitored on a continuous basis to verify, among other things, adherence to the provisions

Figure 26

INTEREST RATES ON U.S. TREASURY BONDS AND THE DOLLAR AGAINST THE YEN AND THE EURO IN THE UNITED STATES - 2004



1/ According to the reverse relationship between price and rate of return, the price of a fixed-income asset decreases as the rate increases.
2/ The direct euro/dollar price means the euro loses value as it approaches zero.
3/ The inverse dollar/yen price means the yen loses value as it approaches zero.
Source: Bloomberg L. P.

28 The Good Delivery gold price (99.5% purity) on the international market (FIX A. MILLION. London) dropped from US$417.25 an once on December 31, 2003 to US$393.75 on June 30, 2004.

established by the internal reserve committee, the security and safety of acquired assets, compliance with obligations derived from their management, financial performance compared with the reference portfolio, and the effectiveness of management in handling liquidity, exchange, credit and market risks. (ii) The risk factors in internal operating procedures are reviewed. (iii) External portfolio managers and custodians are visited regularly to examine the internal control environment they have established to manage and control the resources entrusted to them.

B. Indicators of External Vulnerability

The three most relevant indicators for evaluating Colombia's external vulnerability are (i) year to date reserves/amortization; (ii) reserves/total external debt service; and (iii) reserves/(amortization + current account deficit). The first is sufficient in countries where there is no current account deficit or the currency is overvalued. This means the need for international liquidity is limited to retirement of the public debt. The second is relevant when the country must resort to the international market to finance retirement of the total debt as well as the interest on these liabilities. The third indicator is particularly useful for measuring the external vulnerability of countries with major debt amortization and interest payments, current account deficits, and a desire to avoid fast and sharp adjustments in the current account prompted by recessive effects that produce excessive and uncontrolled devaluation in the case international markets become closed to them.

International markets keep a close watch on each country's characteristics and the value of its indicators. When the relevant indicator is below 1.0, it signals external vulnerability of the economy being considered for investment.

International markets keep a close watch on each country's characteristics and the value of its indicators. When the relevant indicator is below 1.0, it signals external vulnerability of the economy being considered for investment.

Table 23 shows the international reserve indicators for Colombia during the period from 2002 to 2004. The external debt "amortization indicators" are expected to exceed 1.0 for 2004 and 2005, varying between 1.13 and 1.28. The "total debt service" and "adequate liquidity position" indicators are calculated at levels below 1.0, except for 2003 and 2004. For example, the reserve/(amortization + current account deficit) indicator is less than 1.0 for each year between 2002 and 2005, except in 2004. The reserves/ total debt service ratio would be 0.98 in 2004 and 0.96 in 2005.

Table 23

Indicators of Colombia's International Reserves

	2002	2003	2004	2005
Balances				
Gross international reserves (GIR) (millions of dollars) **(*)**	10,844	10,921	11,091	11,185
Indicators				
A. External debt amortization indicator				
External debt amortization (millions of dollars)	10,144	9,925	8,679	8,985
Current account deficit (millions of dollars)	(1,488)	(1,418)	(1,614)	(2,905)
Gross reserves/external debt amortization - current year	1.07	1.10	1.28	1.24
Gross reserves/external debt amortization - following year	1.09	1.26	1.23	1.13
B. Adequate external liquidity position				
GIR/ (Debt service - current year)	0.86	0.89	0.98	0.96
GIR/ (Debt service - following year)	0.88	0.97	0.95	0.88
GIR/ (Debt amortization - current year + c,a, deficit - current year)	0.93	0.96	1.08	0.94
GIR/ (Debt amortization - following year + c,a, deficit - following year)	0.96	1.06	0.93	0.89

(*) The figures of international reserves as of 2004 are estimates.
Source: Banco de la República, SGEE, Programming and Inflation Department.

Box 3

Factors Affecting the Price of a Fixed-Income Asset

International reserves are invested almost entirely in fixed-income assets. A fixed-income asset is a debt instrument issued by an institution at interest, with a rate or reference level that is known from the time of issue. Assets of this type may be issued with short-term (less than one year) or long-term (more than one year) maturity and are tradable on the secondary market. The price of a fixed-income asset is the present value of its cash flows. +}Therefore, to determine the price of an asset, it is necessary to know or assume two basic components: (i) cash flows and (ii) the discount rate used to bring the cash flow to the present value. In terms of a formula, the price of an asset is:

$$P = \frac{fc_1}{(1+tm_1)^1} + \frac{fc_2}{(1+tm_2)^2} + \cdots + \frac{fc_n}{(1+tm_n)^n}$$

where P is the price of the asset, fc_i is the cash flow at moment i, and tm is the market rate (or discount rate) for due date i.

With fixed-income assets, all cash flows are usually known in time. Consequently, the fc_i is known and remains fixed in time. The market rates (tm_i) are also known. Generally, they are the domestic rates of return on government bonds that mature in i years. These rates fluctuate daily, reflecting expectations of inflation, liquidity, risk compensation and other factors of market participants. Accordingly, it can be assumed that fc_i is fixed and constant in time, while tm_i varies frequently. Using basic algebra, it is possible to infer that, as tm_i changes, so does P. Particularly, the ratio between tm_i and P is a reverse ratio. In other words, if one increases, the other declines and vice versa. In a simple example, it is assumed that the instrument consists of just one cash flow at a value of 100, which occurs within one year. If tm_1 is 5%, P should be equal to:

$$P = \frac{fc_1}{(1+tm_1)^1} = \frac{100}{(1+5\%)} = 95.24$$

If the rate increases to 10%, the price of the instrument will decline and be:

$$P = \frac{fc_1}{(1+tm_1)^1} = \frac{100}{(1+10\%)} = 90.91$$

Likewise, if the market rate declines by 2.5%, the price of the instrument will increase and be equal to:

$$P = \frac{fc_1}{(1+tm_1)^1} = \frac{100}{(1+2.5\%)} = 97.56$$

The return on an asset is also affected by the currency in which it is denominated. If the asset is denominated in local currency, this factor does not affect the return. If it is denominated in a foreign currency, the bondholder will not only have the income from interest incurred on the bond and from the change in market price, but also a return on the variation of the currency in which the bond is denominated compared with the local currency.

In a simple example, let us assume the investor is located in the United States (where the local currency is the dollar) and invests in a bond denominated in euros. As with the previous example; that is, a one-year bond with a one-time payment of 100 euros at maturity, it is assumed the market rate in Europe is 5% at the time of purchase and the euro/U.S. dollar exchange rate is 1,0000. The investor will have to pay 95.24 euros for the bond, which is equivalent to US$95.24. After one month, the dollar/euro exchange rate is 1.0500 and the investor decides to sell the bond, for which the market price is 95.24 euros. This amounts to US$100.002. In terms of euros, the investor earns no profit, since the purchase price is equal to the sale price. However, in dollars, which is the investor's currency, the profit is US$4.762, which is the difference between the amount received in dollars from the sale, minus the amount in dollars paid to purchase the bond.

V. Financial Situation of Banco de la República

Profits for 2004 are projected at 140.3 billion pesos. Even if Banco de la República were to register a loss in 2004 due exchange devaluation, it could be covered with existing reserves.

A. Results at June 2004

At the close of June 2004, Banco de la República registered $41.336.4 billion pesos in total assets. This amount is $2.371.3 billion pesos less than at December 2003. There were several reasons for the reduction: (i) a decline in the financial system's demand for repos and temporary liquidity support (1,790.0 billion pesos less); (ii) a drop of 932.8 billion pesos in the TES B portfolio for monetary regulation; and (iii) a reduction in the value of contributions to international organizations (104.6 billion pesos) owing to appreciation of the peso (4.0%).[29] Gross international reserves (GIR) rose by 570 billion pesos, thanks to an accumulation of US$670.1 million (Table 24).

Liabilities came to 20,438.1 billion pesos and equity to 20,898.3 billion pesos, with respective negative changes of 324.8 billion pesos and 2,046.5 billion pesos. An important element with respect to liabilities was the decline of 1,373.5 billion pesos in base money and the increase of 803.9 billion pesos in General Treasury deposits with Banco de la República.

The negative peso-dollar exchange adjustment on international reserves (1,240.2 billion pesos) was responsible for the drop in equity, owing to appreciation in the peso during the course of the year and profits (802.8 billion pesos) turned over to the government. Also significant was the increase of 630.9 billion pesos in capital reserves associated the 730.3 billion

[29] Appreciation was due to fluctuation in the TRM during the period, as well as changes in the ruling on dollar-to-peso conversion for financial stations. For example, the exchange rate used on December 31, 2003 was 2,807.2 pesos, which was the average TRM for all working days in the month. This is pursuant to External Circular N. 84, which was issued by the Banking Superintendent on February 23, 2004.

TABLE 24

BALANCE SHEET - BANCO DE LA REPÚBLICA - EARNINGS 2003-2004
(BILLIONS OF PESOS)

	December 2003		June 2004 1/	
	Balances %	**Share**	**Balances %**	**Share**
Assets	43,707.7	100.0	41,336.4	100.0
Gross international reserves	30,658.4	70.1	31,228.4	75.5
Contributions with international organizations	3,253.9	7.4	3,149.3	7.6
Investments	3,201.4	7.3	2,186.2	5.3
Consolidated public-sector debt	81.4	0.2	0.0	0.0
Public sector monetary regulation	3,061.0	7.0	2,128.1	5.1
Bonds pubic banks - Fogafin - and others	59.1	0.1	58.1	0.1
Loans	85.1	0.2	5.0	0.0
Public sector-National government	2.8	0.0	2.7	0.0
Banks	0.1	0.0	0.0	0.0
Financial corporations	5.1	0.0	3.5	0.0
Other loans 2/	79.2	0.2	0.0	0.0
Less provisions	(2.0)	(0.0)	(1.1)	(0.0)
Resale agreements - Temporary liquidity support	3,597.9	8.2	1,807.9	4.4
Accounts receivable	104.4	0.2	78.2	0.2
Other net assets	2,806.5	6.4	2,881.3	7.0
Liabilities and Equity	43,707.7	100.0	41,336.4	100.0
Liabilities	20,762.8	47.5	20,438.1	49.4
Foreign currency liabilities affecting international reserves	16.2	0.0	9.7	0.0
Base money	16,614.6	38.0	15,241.1	36.9
Currency in circulation	14,398.3	32.9	12,874.4	31.1
Coins	372.4	0.9	380.0	0.9
Deposits for bank reserves	1,694.1	3.9	1,828.8	4.4
Current account deposits - Rest of financial sector	149.8	0.3	157.8	0.4
Other deposits	72.2	0.2	435.2	1.1
National government - National Treasury	46.0	0.1	849.9	2.1
Obligations with international organizations	2,643.5	6.0	2,514.7	6.1
Liabilities for external lines	184.1	0.4	153.5	0.4
Instruments for monetary and exchange regulation	28.5	0.1	142.9	0.3
Contraction repos	28.0	0.1	142.5	0.3
Foreign currency instruments for financing and deposit reserve. 5/97 B,D,	0.4	0.0	0.4	0.0
Others	0.1	0.0	0.0	0.0
Cuentas por pagar	42.6	0.1	50.2	0.1
Otros pasivos	1,115.1	2.6	1,040.7	2.5
Total Equity	22,944.9	52.5	20,898.3	50.6
Capital	12.7	0.0	12.7	0.0
Reserves	893.2	2.0	1,524.1	3.7
Equity surplus	19,553.4	44.7	18,326.8	44.3
CEC liquidation	453.5	1.0	453.5	1.1
Exchange adjustment 1993 and thereafter and surplus	19,054.9	43.6	17,814.7	43.1
Others	45.0	0.1	58.7	0.1
Revaluations	1,038.2	2.4	1,038.4	2.5
Earnings	1,447.4	3.3	(3.6)	(0.0)
Profits and/or losses for the period	1,447.4	3.3	(3.6)	(0.0)

1/ Figures subject to review.
2/ Includes the portfolio of collateral called in for failure to pay off liquidity quota loans.
Source: Banco de la República.

pesos set aside as a reserve for currency fluctuations and the use of 99.4 billion pesos in reserves due to exchange results and protection of assets.[30]

The income statement showed 3.6 billion pesos in losses (Table 25). This was the result of 364.1 billion pesos in income and 367.8 billion pesos in outlays by the close of June 2004. Compared with the same period in 2003, income is down by 635.3 billion pesos (63.6%) and outlays are up by 130.5 billion pesos (55.0%). The change in income is due mainly to international reserves, which saw a negative return of 4.6 billion pesos for the current year. This was caused by devaluation of the euro and the yen against the dollar and the drop in gold prices. These events were a switch from the situation during the same period in 2003, when international reserves produced a return of 667 billion pesos. It is important to note that Banco de la República would have 130.6 billion pesos in profits for distribution at June, if the existing reserve is used to cover the losses resulting from the fluctuation in currency,

The primary sources of income up to June include 169.1 billion pesos in revaluation of the TES B portfolio for monetary regulation, 66.3 billion pesos in commissions (earned basically for banking services), and 62.2 billion pesos in interest received for the transitory purchase of securities (repos). The major expenses include 82.0 billion pesos in employee expenses, 69.5 billion pesos in remuneration on deposit accounts, 59.4 billion pesos in retirement pensions and 47.4 billion pesos in changes in liabilities with international organizations.

B. Projected Income and Expenses For 2004

Given 885.6 billion pesos in estimated income and 745.3 billion pesos in estimated outlays, the profit projected for 2004 is 140.3 billion pesos (Table 25). The main sources of income will be TES revaluation for monetary regulation, 334.5 billion pesos; revaluation of international reserves, 230.7 billion pesos; commissions received (primarily for banking services), 124.2 billion pesos; and coin issue and precious metals, 43.0 billion pesos. The main expenses will be for employees, 168.0 billion pesos; interest paid on deposit accounts, 129.0 billion pesos; retirement pensions, 121.9 billion pesos; the cost of currency issue, 88.6 billion pesos; the change in liabilities, 52.5 billion pesos; and general expenses, 46.7 billion pesos.

With respect to the foregoing, it is important to note that profits in the current projection are down by 195.1 billion pesos compared with the calculation in the March report (335.4 billion pesos). This is explained by:

Given 885.6 billion pesos in estimated income and 745.3 billion pesos in estimated outlays, the profit projected for 2004 is 140.3 billion pesos.

31 See the *Report of the Board of Directors to the Congress of the Republic,* March 2004, Table 27, pg. 87.

Table 25

Income Statement - Banco de la República, 2003 - 2004
(Billions of pesos)

	Execution Jan-Jun. 2003		Execution Jan-Jun. 2004 1/	
	Flows	Share %	Flows	Share %
I. Total income	999.5	100.0	364.1	100.0
1. Operating income	994.5	99.5	359.0	98.6
Income and returns	890.9	89.1	236.7	65.0
International reserves	666.6	66.7		0.0
External lines	2.7	0.3	0.5	0.1
Valuation of TES «A» market prices	4.3	0.4	0.0	0.0
Valuation of TES through monetary expansion operations	177.5	17.8	169.1	46.4
Transitory purchase of securities and quotas	31.1	3.1	62.2	17.1
Others	8.8	0.9	4.9	1.3
Commissions	56.3	5.6	66.3	18.2
Banking services and trust business	41.8	4.2	48.1	13.2
Foreign currency management	11.8	1.2	13.2	3.6
Others	2.7	0.3	5.0	1.4
Exchange differences	29.1	2.9	23.2	6.4
Coin issue and precious metals	0.0	0.0	11.8	3.2
Others	18.2	1.8	21.0	5.8
2. Non-operating income	5.0	0.5	5.1	1.4
II. Total expenses	237.3	100.0	367.8	100.0
1. Operating expenses	236.0	99.4	367.5	99.9
Interest and returns	72.3	30.4	99.9	27.2
International reserves			4.6	
Reserve requirement on deposit accounts	47.3	19.9	69.5	18.9
Transitory sale of securities	6.0	2.5	7.5	2.0
Expenses for international reserve management	14.0		14.3	
External lines and exchangeable instruments	5.0	2.1	4.1	1.1
Commissions and fees	1.7	0.7	1.2	0.3
Exchange differences	22.1	9.3	50.2	13.6
International organizations	7.5	3.2	47.4	12.9
External lines	11.9	5.0	1.6	0.4
Others	2.6	1.1	1.1	0.3
Cost of issuing notes and coins	14.7	6.2	31.1	8.5
Employee expenses	79.0	33.3	82.0	22.3
Retirement pensions	0.6	0.3	54.9	14.9
General expenses	19.3	8.1	20.3	5.5
Taxes	2.2	0.9	2.9	0.8
Insurance	5.1	2.1	5.5	1.5
Contributions and membership	1.3	0.5	1.8	0.5
Cultural expenses	2.8	1.2	2.6	0.7
Provisions, depreciation and amortization	13.8	5.8	13.4	3.6
Other operating expenses	1.1	0.5	1.8	0.5
2. Non-operating expenses	1.3	0.6	0.2	0.1
III. Profits or losses in the period. including depreciation	762.2	321.2	(3.6)	(1.0)

n.a. Not applicable.
1/ Figures subject to review.
2/ Changes in excess of 200%.
Source: Banco de la República.

Change Jan-Jun 2004-2003		Execution Jan-Dec. 2003		Projection Jan-Dec. 2004		Change Jan-Dec 2004-2003	
Absolute	%	Flows	Share %	Flows	Share %	Absolute	%
(635.3)	(63.6)	2,031.2	100.0	885.6	100.0	(1,145.6)	(56.4)
(635.5)	(63.9)	1,990.1	98.0	878.8	99.2	(1,111.3)	(55.8)
(654.2)	(73.4)	1,802.3	88.7	666.9	75.3	(1,135.4)	(63.0)
(666.6)	n.a.	1,326.3	65.3	230.7	26.0	(1,095.6)	(82.6)
(2.2)	(82.0)	4.5	0.2	0.6	0.1	(3.9)	(87.0)
(4.3)	n.a.	7.7	0.4	0.0	0.0	(7.7)	(100.0)
(8.4)	(4.7)	340.8	16.8	334.5	37.8	(6.3)	(1.8)
31.1	99.7	105.6	5.2	88.4	10.0	(17.2)	(16.3)
(3.9)	(44.3)	17.4	0.9	12.8	1.4	(4.7)	(26.8)
10.1	17.9	121.9	6.0	124.2	14.0	2.3	1.9
6.3	15.0	91.0	4.5	90.8	10.3	(0.2)	(0.2)
1.5	12.4	27.4	1.3	28.3	3.2	0.9	3.5
2.3	86.1	3.5	0.2	5.1	0.6	1.5	43.2
(5.9)	(20.2)	22.3	1.1	27.1	3.1	4.8	21.5
11.8	n.a.	21.3	1.0	43.0	4.9	21.7	101.8
2.8	15.1	22.3	1.1	17.6	2.0	(4.7)	(21.0)
0.1	2.8	41.1	2.0	6.8	0.8	(34.3)	(83.4)
130.5	55.0	583.9	100.0	745.3	100.0	161.5	27.7
131.5	55.7	572.0	98.0	729.2	97.8	157.2	27.5
27.7	38.3	152.3	26.1	178.7	24.0	26.4	17.4
22.2	47.0	103.9	17.8	129.0	17.3	25.0	24.1
1.5	25.5	9.8	1.7	12.8	1.7	3.0	30.6
	0.0	29.4		29.1			
(0.9)	(17.9)	9.1	1.6	7.9	1.1	(1.2)	(13.1)
(0.5)	(31.5)	3.0	0.5	2.3	0.3	(0.6)	(21.4)
28.1	127.1	41.6	7.1	52.5	7.0	10.9	26.2
39.9	2/	18.8	3.2	47.4	6.4	28.6	152.4
(10.3)	(86.2)	20.2	3.5	2.2	0.3	(18.0)	(89.3)
(1.5)	(58.2)	2.6	0.4	2.9	0.4	0.3	12.3
16.4	111.1	89.9	15.4	88.6	11.9	(1.3)	(1.4)
3.0	3.8	156.9	26.9	168.0	22.5	11.0	7.0
54.3	2/	28.9	5.0	121.9	16.3	92.9	321.5
1.0	5.1	43.7	7.5	46.7	6.3	3.0	6.9
0.7	31.3	5.0	0.9	6.0	0.8	1.0	19.9
0.5	9.0	10.5	1.8	13.1	1.8	2.5	23.9
0.5	38.1	2.9	0.5	3.6			
(0.2)	(7.2)	6.6	1.1	7.2	1.0	0.6	9.2
(0.4)	(2.9)	28.1	4.8	37.7	5.1	9.7	34.5
0.7	64.7	2.6	0.4	2.8	0.4	0.2	8.9
(1.1)	(82.3)	11.9	2.0	16.2	2.2	4.3	36.2
(765.8)	(100.5)	1,447.4	247.9	140.3	18.8	(1,307.1)	(90.3)

Banco de la República has a reserve to absorb exchange losses that might result from a change in the dollar against other currencies.

a) Less of a return on international reserves, 46.7 billion pesos, due to (i) devaluation in the second quarter, 135.9 billion pesos[31]; (ii) the exercise of call options in July, US$199.9 million; and (iii) the scheduled sale of foreign currency to the government for US$500 million, with US$100 traded by May 21.

b) More net spending on retirement pensions (82.3 billion) due to devaluation of the pension portfolio between April and June as a result of higher interest rates on TES, which account for 76% of that portfolio.

c) Less return on the TES portfolio for monetary regulation (53.9 billion pesos) due to: (i) a reduction in the portfolio during June and July because of sterilization to offset part of the expansion caused by the exercise of put options to accumulate international reserves; and (ii) devaluation tied to the increase in interest rates on the market for TES trading.

Projected income does not include new revaluation or devaluation of the international reserve portfolio originating with changes in international interest rates and the prices of currencies with respect to the dollar, as well as changes in the TES rates.

As mentioned earlier, Banco de la República has a reserve to absorb exchange losses that might result from a change in the dollar against other currencies. This reserve increases when a rise in the net value of assets and liabilities in foreign currency results in a profit due to exchange variations between the U.S. dollar and other reserve currencies, or declines when this item registers a loss. Therefore, even if Banco de la República were to suffer losses in 2004 due to the impact of exchange devaluation, it is possible they could be covered with the existing reserve.

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[31] The accumulated return on international reserves went from 131.3 billion pesos between January and March to -4.6 billion pesos between January and June.

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